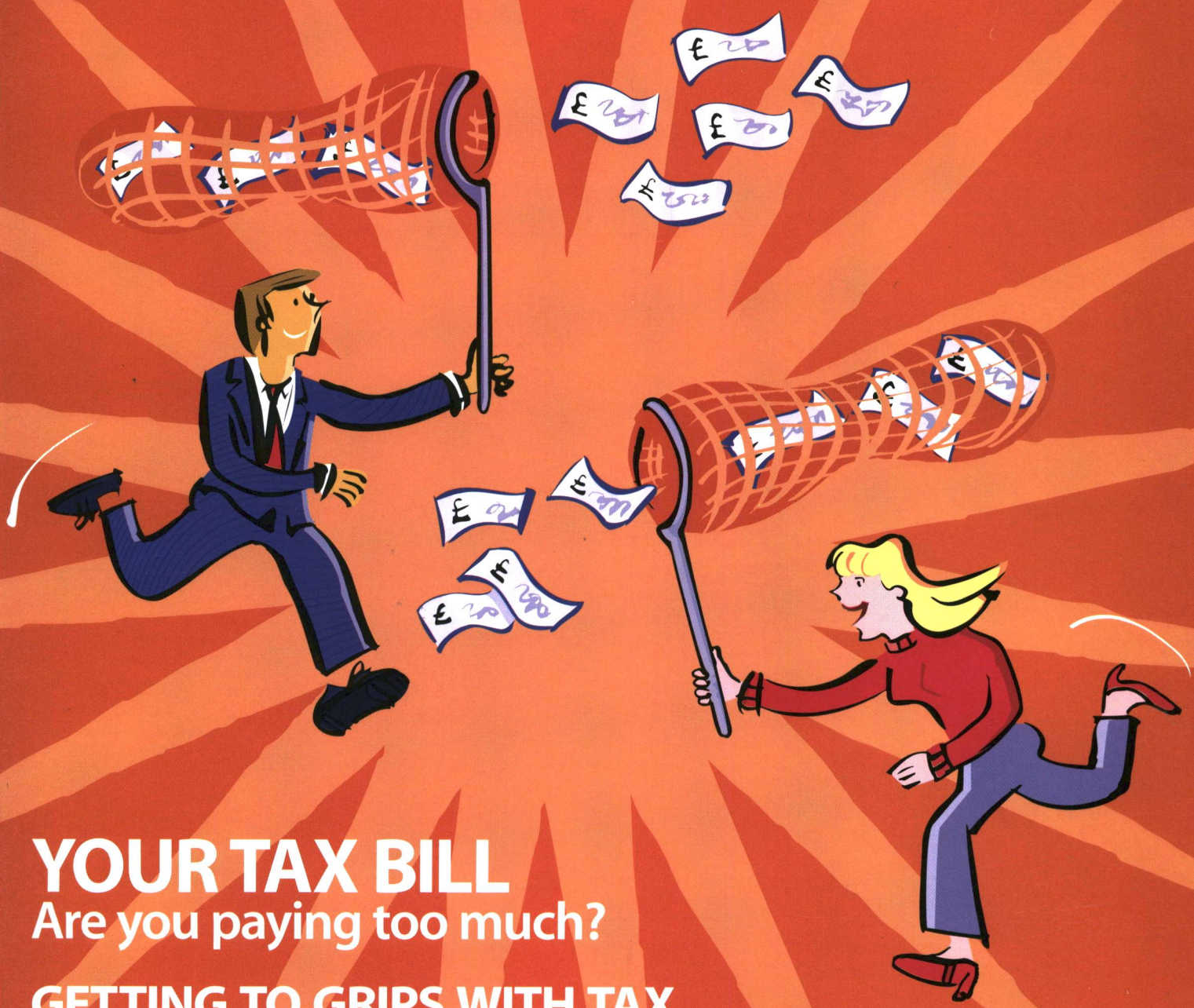
WHICH?

TAX SAVING GUIDE 2002



YOUR TAX BILL
Are you paying too much?

GETTING TO GRIPS WITH TAX
It's not as hard as you think

DEALING WITH THE REVENUE
We show you how

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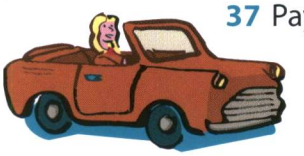

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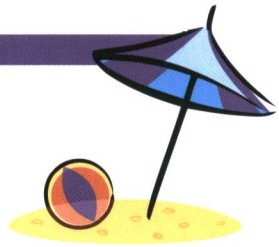

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This year we've combined the *Which? Tax Return Guide* and *Tax Saving Guide* into one to help you fill in your tax return, check your tax bill and sort out queries.

All you ever wanted to know about income tax, tax on savings and more is here. The calculators are still included – we've revised the capital gains tax calculator to make it even more comprehensive. And, because we went to press before the 2002 Budget, we'll be publishing a factsheet (available from end-April) containing all the latest tax changes.

We hope you like the new guide. Let us know what you think.

Kirsten Edwards

KIRSTEN EDWARDS, EDITOR

WHICH?

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Why you need this guide

Your tax bill is probably the biggest bill you pay each year, yet many of us don't bother to check whether we're paying the correct amount.

The *Which? Tax Saving Guide* is designed to help you get to grips with your tax bill, sort out problems with the Inland Revenue and calculate your tax yourself if you want to. Each section explains the basics and tells you how to use the tax rules to your advantage.

TAX CHANGES

This guide will help you check your income tax for the 2001-2002 tax year, which runs from 6 April 2001 to 5 April 2002.

Where possible, we've included details of changes that may not yet be in force but will take effect soon. The changes to personal allowances fall into this category.

The next Budget isn't due until after our guide is published, so we can't give details of tax changes that will apply after April 2002 unless they've already been announced. We'll update you as soon as possible after the Budget is announced.

TAX FACTS

Here are the basic tax facts that apply for 2001-2002, and some that we know about for 2002-2003.

Income tax

Tax on non-savings income (from employment, pensions and self-employment) earned in 2001-2002 is charged at three rates: 10 per cent (starting rate), 22 per cent (basic) and 40 per cent (higher). This type of income is normally allocated against the tax bands first. The table, right, shows the bands of income on which each rate is levied.

National Insurance

In addition to income tax, everyone earning over a certain threshold has to pay National Insurance. In 2001-2002, Class 1 (employee) National Insurance contributions were levied at 10 per cent of earnings between £87 and £575 a week (10 per cent of earnings between £89 and £585 a week for 2002-2003).

Savings and investments

Savings income received in 2001-2002 is charged at three rates. To find out what tax rate your savings income is taxed at, you must add it to your other taxable income. Depending on what tax band it falls into (see table, below), it will be taxed at 10, 20 (not 22) or 40 per cent. Starting- and basic-rate taxpayers pay 10 per cent tax on dividend income, higher-rate taxpayers pay 32.5 per cent.

ALLOWANCES AND TAX BANDS

	2001-2002 tax year (£)	2002-2003 tax year (£)
Personal allowance		
Basic	4,535	4,615
Age-related: if you're 65 to 74	5,990	6,100
Higher age-related: if you're 75 or over	6,260	6,370
Married couple's allowance[1]		
Minimum amount	2,070	2,110
Either spouse aged 65 before 6 April 2000	5,365	5,465
Either spouse aged 75 or over	5,435	5,535
Tax bands		
Starting rate (10%)	up to 1,880	see[2]
Basic rate (22%)	1,881 to 29,400	see[2]
Higher rate (40%)	over 29,400	see[2]

1 Relief restricted to 10 per cent. Married couple's allowance was abolished from 6 April 2000. However, it remains for couples where one or both parties was born before 6 April 1935 or where one person born before 6 April 1935 marries on or after 6 April 2000

2 Information not available at time of going to press

Allowances

Everyone gets a personal tax allowance. This is the amount you can earn before you start to pay tax (see the table, below). People aged 65 or over may get a higher amount, known as age-related allowance.

Prior to 6 April 2000, all married couples could claim an extra allowance, but now this is available only if you or your spouse were born before 6 April 1935. Unlike the personal allowance, it's not an amount you can earn before you start paying tax. Instead, a percentage of the allowance is deducted from your final tax bill and reduces the amount you pay.

Capital gains

In 2001-2002 you could make capital gains of £7,500 before paying capital gains tax. Above this, tax on capital gains is treated in a similar way to tax on savings. The gain is added to your other income and is charged at 10, 20 or 40 per cent, depending on which tax band the gains fall into.

Inheritance tax

In 2001-2002, inheritance tax applies to estates above £242,000, and 40 per cent is charged on death.

Getting to grips with tax

Knowing how the UK tax system works can save you money. This chapter takes you through some basics about tax, and shows how taking our advice can pay off.

In this section we answer some basic questions about tax to help you use the rest of this guide.

WHAT ARE THE MAIN KINDS OF TAX I MIGHT PAY?

You might have to pay some or all of the following taxes in the UK:

- income tax on earnings, pensions, investment or rental income. Your taxable income is often less than the income you actually receive (see 'Is all my income taxed?', right)
- National Insurance (NI) contributions on your income from working or on business profits. Some National Insurance contributions are used to work out whether you qualify for certain state benefits (including the basic state pension, incapacity benefit and bereavement benefits)
- capital gains tax on the disposal or gift of an asset (such as a possession or investment)
- inheritance tax on your estate after you die, and on some gifts that you make during your life
- council tax (domestic rates in Northern Ireland) charged on property by your local authority.
- value added tax (VAT) included in the price of most goods and services, currently at 17.5 per cent (five per cent for domestic fuel).
- stamp duty charged on certain documents – for example, when you sell or transfer property, although it has now been abolished in certain areas for properties of £150,000 or less
- insurance premium tax on premiums for general insurance such as household, motor and travel policies.

DO I HAVE TO PAY TAX ON ALL KINDS OF INCOME?

No. Some sources of income are tax free. For example, money invested in individual savings accounts (Isas) and certain National Savings products will initially be free of both income tax and capital gains tax (see p45). You don't have to tell the Revenue about any tax-free income.

IS ALL MY INCOME TAXED?

Not all of your income is taxed. This is due to allowances, expenses and tax-allowable deductions. Tax-allowable deductions are payments you make from taxable income that normally qualify for tax relief – for example, contributions to pension schemes or some payments to charity. Certain expenses (for example, protective clothing necessary for your job, or fees to professional bodies) count as tax-allowable deductions. Everyone gets a basic personal tax allowance (£4,615 in the 2002-2003 tax year), which is an amount of income you're allowed to receive before you have to pay tax. You may also be entitled to extra allowances if, for example, you or your spouse are over 65 (see p41 for details).

WHICH DEDUCTIONS AND EXPENSES AM I ALLOWED?

Broadly, it depends on the kind of income it is or where it comes from. This is because tax law divides income into schedules. For example, income from letting a property comes under schedule A, income from self-employment under schedule D, and income from working for an employer under schedule E. Each schedule has different rules.

TAX CALENDAR 2002

Keep this timetable handy to check you have received all the documents you need and have sent them back the Revenue in time to avoid penalties.

When	What happens	Who is affected
April 2002	Inland Revenue sends out most returns for 2001-2002 tax year	Everybody who normally gets a tax return
by 31 May 2002	P60s issued providing details of your taxable pay and tax paid for 2001-2002	All employees. Also pensioners who receive an income from a previous employer's pension scheme or private pension plan
by 6 July 2002	P11Ds issued, providing details of your taxable fringe benefits and expenses for tax year 2001-2002	Employees or directors earning £8,500 or above and receiving fringe benefits and/or expenses
31 July 2002	Second payment on account for 2001-2002 tax year due (first one was due by 31 January 2002)	Taxpayers who make payments on account
30 September 2002	Completed tax return must be back to your tax office by now if you want the Revenue to calculate your tax bill	Taxpayers who want the Revenue to calculate tax due for 2001-2002. Also people who want underpayments of tax of up to £2,000 collected by PAYE
6 October 2002	Advise the Inland Revenue of new untaxed income received or change of status in 2001-2002 tax year	Taxpayers who start to receive untaxed income during the 2001-2002 year or who have changed status (eg, from employment to self-employment)
31 January 2003	Final deadline for sending back your tax return and paying any outstanding tax due for 2001-2002	Everyone who receives a tax return before 31 July 2002.
	First payment on account for 2002-2003 tax year	Taxpayers who make payments on account
	Revenue must tell you by now if it wants to start an enquiry into your 2000-2001 return	Taxpayers who may have a problem on their return or picked at random
28 February 2003	5 per cent surcharge on any unpaid tax from 2001-2002	Everyone due to pay on 31 January but who failed to do so

HOW MUCH OF MY INCOME WILL BE TAXED?

To find your taxable income, you add up all the income you receive in one tax year, but exclude payments not classed as income, such as any inheritance, gifts and capital gains you may receive. Include any taxable benefits from your employer (see 'Fringe benefits', p23) and deduct any allowable expenses. Ignore any tax-free income. This sum is your gross income. From this, deduct any tax-allowable deductions (pension contributions, for example) to arrive at what's called your total income. From total income, you then deduct your personal allowance and any other full-relief allowances you may be entitled to (but not any allowance on which the relief is limited, such as the children's tax credit). This will give you your taxable income (see our income tax calculator, p64).

HOW DOES THE INLAND REVENUE COLLECT TAX?

There are three main ways in which the Revenue collects tax.

PAYE

If you work for an employer or receive an employer's pension, tax is usually collected by your employer under the Pay As You Earn (PAYE) scheme – see 'PAYE income', p17.

If most of your income is taxed under PAYE, and you also have some untaxed income from another source, you can usually pay the extra tax via PAYE. If, on the other hand, you receive your income without tax deducted, but you are liable for tax, your tax return notifies the Inland Revenue of how much income you received during the tax year. Either you or the Revenue will then be able to calculate the tax you owe on the basis of the information you supply in the tax return.

Savings and dividends

The income from most types of investments is paid to you net of tax at the special savings rate of 20 per cent, with further tax to pay only if you're a higher-rate taxpayer. Starting-rate taxpayers may be able to claim back half of the tax, and non-taxpayers all of it (see 'Savings and investments', p44). Dividends from UK shares and distributions from unit trusts are paid net of tax at 10 per cent. Starting- and basic-rate taxpayers pay no more tax, but non-taxpayers can't claim this notional tax back. Higher-rate taxpayers pay more (see 'Savings and investments', p44).

Self-employment

Self-employed people have to pay some tax before they submit their tax return. These payments, called payments on account, are based on your tax bill for the previous tax year (see p37). One payment is due by 31 January of the tax year in question and the other by 31 July following the end of the tax year. If, after submitting your tax return, you find more tax is due, you must pay it by 31 January following the end of the tax year.

CAN I AVOID PAYING TAX?

Tax avoidance – where you arrange your financial affairs so as to pay as little tax as possible – is a recognised principle, and is legal. But tax evasion – where you conceal income or gains from the Inland Revenue, or fraudulently claim allowances or other deductions – is a criminal offence, and the penalty for it can be a fine or imprisonment.

MORE HELP
- Dealing with the Revenue **p6**
- Income tax calculator **p64**
- Payments on account **p37**
- PAYE income **p17**
- Fringe benefits **p23**
- Tax for older people **p41**
- Savings and investments **p44**
- You and your family **p57**

Dealing with the Revenue

Knowing what the Inland Revenue expects from you, and what your rights are, will help you pay the right amount of tax due – no more and no less.

We tell you your responsibilities when dealing with the Revenue, and what your rights are.

PAYING THE PENALTY

Even if you use a tax adviser or accountant, you are the one responsible for making sure the information on your tax return is accurate and that the Revenue receives the return in time. There are stiff penalties if you miss the deadlines. If you miss the final return date (for most returns this will be 31 January 2003 for the tax year ending on 5 April 2002), the Revenue will charge you a fixed penalty of £100. If the return is still outstanding six months later, you will be charged another £100. A further penalty of up to £60 a day can be applied in more serious cases. However, the penalty payable can never exceed the balance of tax due.

If you're late paying your tax, you will be charged interest, currently at an annual rate of 6.5 per cent. In addition, a 5 per cent surcharge will be applied on any tax not paid by 28 February 2003. This surcharge will be increased to 10 per cent and applied to any tax bill still unpaid by 31 July 2003.

The Revenue can start legal proceedings to enforce collection of overdue tax. However, you can appeal against the penalties and surcharges if you think you have a reasonable case – see Inland Revenue booklets SA/BK6 and SA/BK7 for more information. You should also claim against your accountant or tax adviser if you think they are at fault.

PAYING THE WRONG TAX

If you are paying too much tax because of a mistake you made on your tax return in a previous year, use question 19 on your current tax return to claim a refund – if you aren't normally sent a tax return, contact your tax office.

On the other hand, you may be paying too little tax. The Revenue will let you know if this is so once it has received your tax return, though you can challenge its decision – see 'Appeals against tax', opposite. If you're taxed through the PAYE system, any overdue tax can normally be collected by reducing your PAYE code for the coming year, but only if you file your return by 30 September and you owe less than £2,000.

MISTAKES

By the Revenue...

If you have paid too much tax because of a mistake by the Revenue or any other government department, you can claim a rebate for the affected period, even if it exceeds the statutory time limit of six years. This applies where there is no dispute or doubt about the facts. This rule is covered in booklet IR1 *Extra-Statutory concessions*, B41. You may also be entitled to compensation.

If the mistake is serious, the Revenue will pay reasonable costs you incur, such as postage and professional fees, as well as earnings you lost through having to sort things out. Even if the mistakes aren't serious, but the Revenue persists in making them, it may pay some costs. For more information, see Inland Revenue Code of Practice 1.

By you...

If you have paid too much tax because of an error or mistake that you made in your tax return, you can claim repayment up to six years later. This rule is also covered in Revenue booklet IR1 *Extra-statutory concessions*, B41.

YOUR RIGHTS

The Inland Revenue service standards are covered in the Charter for Inland Revenue Taxpayers and the Charter for National Insurance Contributors, both of which commit the Revenue to offering a fair, effective and confidential service. The charters confirm its customer service standards and also cover your right of appeal against the Revenue's decisions. They also remind you of your legal duty to disclose all necessary information. The charters are backed up by Inland Revenue codes of practice.

For example, if the Revenue takes more than six months after its 28-day target to reply to queries, it will waive interest on unpaid tax that arose during the period of delay, pay interest on any money owed during this period, and pay reasonable costs incurred because of the delay. There is also an independent Adjudicator who can rule on handling complaints (see 'Resolving complaints', opposite).

MORE HELP

Inland Revenue leaflets
IR37 Appeals
IR73 Inland Revenue enquiries under self assessment
IR141 Open government

Codes of practice
1 Mistakes by the Inland Revenue
6 Collection of tax
10 Information and advice
11 Enquiries into tax returns by local tax offices

Adjudicator's Office leaflets
AO1 How to complain about the Inland Revenue and the Valuation Office Agency
AO2 How to complain about Customs and Excise

THE WRONG TAX CODE

For the past two years, Maria Coles has been told by the Inland Revenue that she's underpaying tax. Maria, who works as an IT training team leader and pays tax via PAYE, couldn't understand why this was happening to her, as colleagues in a similar position weren't facing tax demands. She was so exasperated that she called her tax office and asked them to sort it out.

The tax office went back over Maria's records to find out what had happened and how it would be rectified. It turned out that Maria's tax code didn't take into account some of the benefits in kind she received from her company, such as an annual travel card. This meant she wasn't paying enough tax.

Maria's PAYE code has been adjusted this year to pay back the tax she owes. As a result, she should now be paying the correct amount of tax.

APPEALS AGAINST TAX

If you think your tax bill is wrong and you can't agree the final amount, you can lodge an appeal – see Inland Revenue leaflet IR37 *Appeals* for more details.

If you don't agree with the outcome, you can appeal to independent commissioners and be represented at the hearing by a tax adviser, accountant or lawyer.

RESOLVING COMPLAINTS

Try to resolve any complaints with your tax office in the first instance by writing to the officer-in-charge. If this fails, contact the Regional Controller – contact your tax office for details. If you are still not happy, you can ask the independent Adjudicator to look into your complaint. The Adjudicator will consider complaints about excessive delays, mistakes, discourtesy and the way in which the Inland Revenue has exercised its discretion. To find out more about the Adjudicator, go to www.adjudicatorsoffice.gov.uk or phone 020 7930 2292.

As a last resort you can make a complaint to the Parliamentary Commissioner for Administration (the Ombudsman). However, you must be referred via an MP. The Adjudicator's Office can't deal with complaints that the Ombudsman has considered, so try the Adjudicator's Office first.

During 2000-2001, the Adjudicator recommended that the Revenue pay over £481,000 to complainants.

AFTER COMPLETING THE RETURN

What happens after you've sent back your tax return depends on whether you work out your own tax or whether you ask the Inland Revenue to do it for you.

If the Revenue works out your tax...

Your tax office will check your return for simple, obvious errors or miscalculations, and then work out how much tax you owe. It will send you a 'tax calculation' which confirms the tax due and when it must be paid.

Your tax office will usually correct any mistakes or miscalculations in your return without checking with you first, but it must inform you of any changes it has made. There is a page on the statement headed 'Revisions made to your Tax Return' that states what changes your tax office has made and why.

You should check the Revenue's calculations straight away as it may have missed something. You can challenge any amendments you don't agree with.

If you do it yourself...

If your tax office agrees with your calculation, you will receive a notice telling you that your return has been processed successfully.

However, if your tax office finds a mistake or miscalculation, it will amend your return and send you a tax calculation statement giving ▶

SELF-ASSESSMENT PROBLEMS

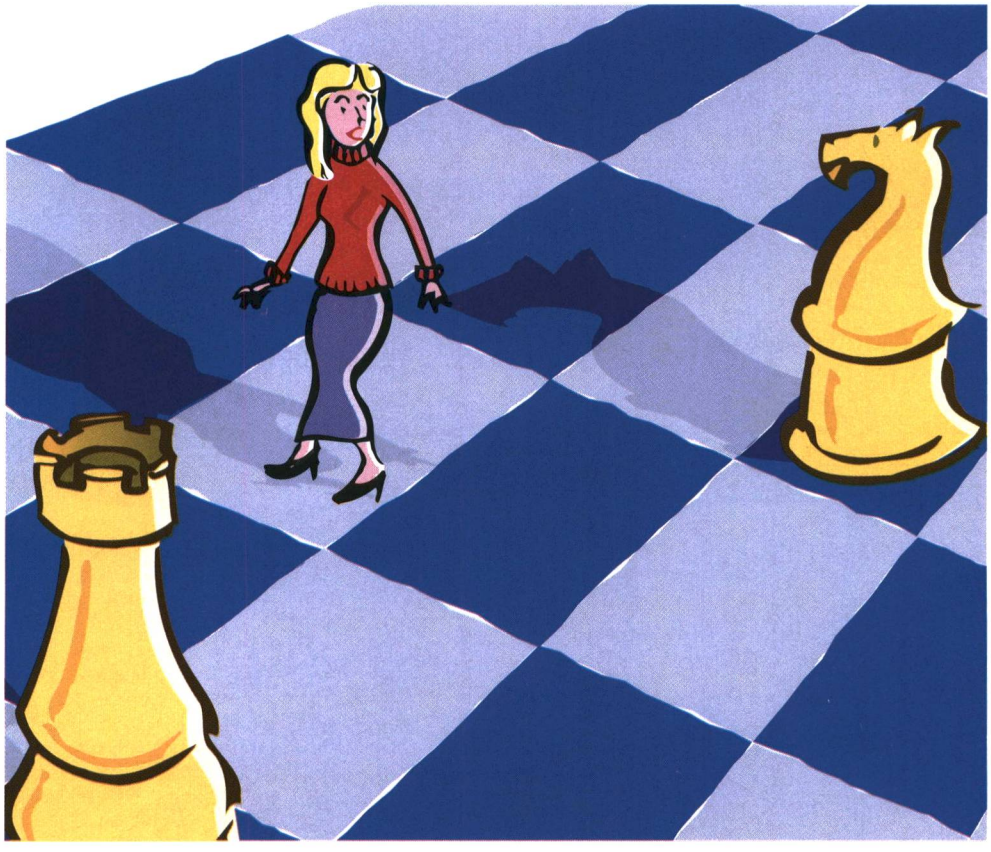
If your self-assessment calculation is amended by the Inland Revenue The Revenue must explain how it arrived at the amendment and will try to reach agreement. If you do not understand, contact your tax office immediately, asking it to explain the calculations in more detail.

If you still don't agree with the amendment You can appeal against any amendment the Revenue makes to your self assessment, or against any other assessment the Revenue makes, if you do not think it is correct. You will have 30 days from the date you are advised of the amendment.

If you cannot reach agreement with your tax office following the lodging of your appeal You can appeal to independent appeal commissioners. General commissioners deal with most cases. Special commissioners deal with cases that require expertise – you may request that your case be heard by one of these. You can be represented by, for example, a lawyer, accountant or tax specialist (such as a member of the Chartered Institute of Taxation). While this can be expensive, it may make the difference between winning and losing.

If you don't agree with the commissioners' decision on a point of fact No further appeal normally, but you can complain about maladministration by the Revenue if applicable – see 'Problems with your tax office, p8.

If you don't agree with the commissioners' decision on a point of law You can take your case to the High Court in England and Wales (the Court of Session in Scotland or the Court of Appeal in Northern Ireland). Tell the commissioners' clerk in writing within 30 days, enclosing £25. This route could be costly, and interest will build up on any tax due.



PROBLEMS WITH YOUR TAX OFFICE

Are you worried that too much tax is being deducted, or that your allowances are wrong? Make sure that you've got the facts right about the allowances you're entitled to. Check your latest coding notice and payslip to ensure that your employer is using the correct PAYE code (see p18).
Still puzzled? Ring your tax office or local tax enquiry centre to check the rules (see 'Finding your tax office', below). Get it to say exactly which rules it thinks apply.
Approach your tax inspector Give your name, National Insurance number and tax reference number. Take a note of the tax inspector's name. Keep copies of letters.
Have you met with delay, rudeness, maladministration or incompetence? Remind the inspector of your rights under the taxpayers' charter. More than six weeks' delay is worth complaining about.
Still got nowhere? Write to the officer-in-charge at your tax office, whose name is on tax office letters. Head your letter 'Complaint'.
If this fails Write to the regional controller for the area responsible for your tax office. Your tax office will tell you how.
No joy with the controller? Contact the Adjudicator's Office, Haymarket House, 28 Haymarket, London SW1Y 4SP. You can telephone first (020 7930 2292) to make sure it can investigate your complaint.
Still unhappy, or have you met with extreme delay or maladministration? Through an MP, you can complain to the Parliamentary Commissioner for Administration (the Ombudsman). The Adjudicator won't deal with matters investigated (or still under investigation) by the Ombudsman.

your revised tax bill. As before, if you don't agree with these amendments or revisions, you can challenge them.

If you send back your return and pay your tax just before the final filing date, then there may not be time for the Revenue to advise you of any mistakes before the deadline. If you've unwittingly underpaid tax, you will be charged interest on this after the deadline has passed. So, if possible, send back your return in time for any mistakes or omissions to be picked up before the final deadline.

THE TAX CALCULATION

In the past, the tax calculation has been the subject of a lot of criticism, with many taxpayers finding it difficult to follow. The Revenue has made some changes to it, but whether this has resulted in an improvement is yet to be seen. If you don't understand your tax calculation, ask your tax office or a local tax enquiry office (in the phone book under 'Inland Revenue') to explain it to you.

STATEMENT OF ACCOUNT

This is a written record of your transactions with your tax office. It confirms the tax you owe (for both the current tax year and in advance for next year, if applicable), any arrears, and what tax you've paid.

Statements of account are sent to all taxpayers who receive a tax return (unless the amount owed is nil). Taxpayers making payments on account (see p37) will receive two. It's unlikely you will receive a statement of account if you pay all your tax via PAYE.

ENQUIRIES INTO RETURNS

The Inland Revenue will check your tax return when it first receives it for simple or obvious errors. Later, it may check it more thoroughly. The Revenue has the right to open an enquiry into anybody's tax return. Most of the returns it selects for enquiry will be those it thinks might be incorrect or incomplete.

However, it will also select, completely at random, some 7,500 returns for full enquiry (see 'Types of enquiry', right). The Revenue chooses these returns at the time they are dispatched, so whether you file your tax return early or late, the Revenue will still open an enquiry if your return is among those selected. It doesn't have to tell you whether your return is among those chosen at random, or whether it is opening an enquiry for another reason.

TYPES OF ENQUIRY

There are two types of enquiry – a full enquiry, which involves looking into the return as a whole, and an aspect enquiry, which concentrates on specific aspects (the amount paid to pension schemes, or the calculation of a capital gain, say). The Revenue has a code of practice for enquiries, which it must follow. For example, it must:

- tell you in writing that it intends to start an enquiry, and what your rights and responsibilities are
- try to tell you at the same time what information it requires. If it can't do this at the outset, it must explain why and say when you can expect to be told
- allow you to have professional representation, for example, by an accountant. You are responsible for making sure your adviser has all the facts.

The Revenue must tell you within 12 months of the final filing date (or the date you submit your return, if later) if it intends to start an enquiry.

The final filing date for most returns for the 2001-2002 tax year is 31 January 2003, so for these returns your tax office must notify you by 31 January 2004 if it intends to open an enquiry into your tax return for 2001-2002. For more information on enquiries, see Code of Practice 11.

FINDING YOUR TAX OFFICE

If you have a general enquiry about tax, phone one of the tax enquiry centres. You'll find them listed in the phone book under 'Inland Revenue'.

If you have a specific enquiry about your tax affairs, contact your own tax tax office. You should be aware that this won't necessarily be the one closest to you. If you are an employee or your main source of income is a pension from a former employer, your tax office will depend on the location of your employer's main office or whoever pays the pension. If you're self-employed, your tax office depends on your business address. If you're unemployed, you remain with your last tax office. And if your only sources of income are from investments, it is the office that covers your home address.

Even if you have different sources of income, you should have only one tax office to deal with.

The basic tax return

Everyone who gets a tax return to complete will receive the standard ten-page return, which we go through in this chapter.

The Inland Revenue sends out its own guide with your tax return (unless you have a tax adviser) and provides helpsheets on certain subjects. We've referred to specific pages of the Revenue guide, or Revenue helpsheets, that might help you when you come to fill out your own return.

WHAT DOES SELF ASSESSMENT MEAN?

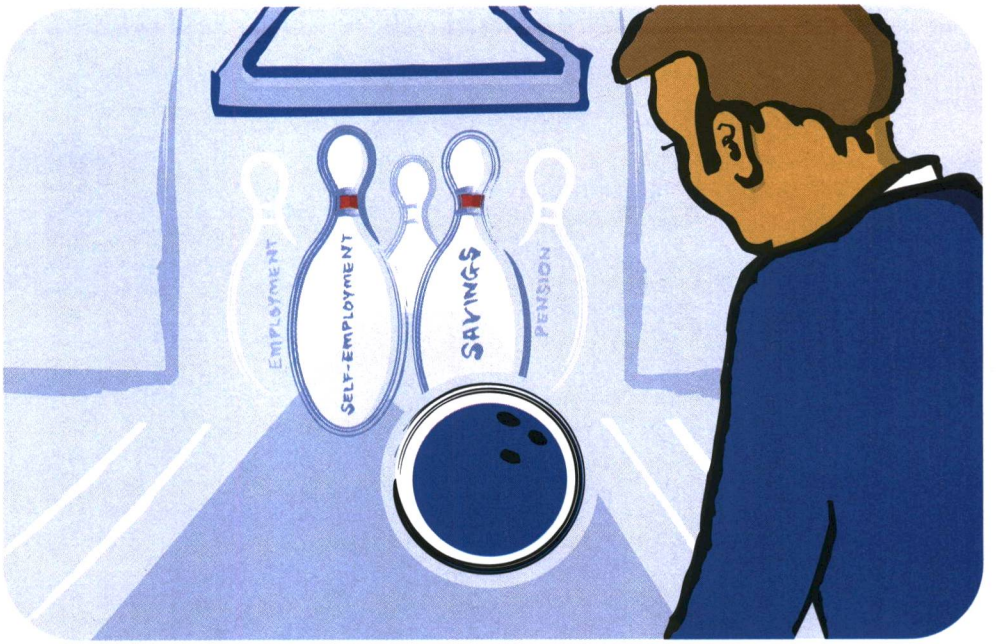
Self assessment simply means that you assess your tax position by telling the Revenue what income you received in the tax year and what tax reliefs and allowances you were entitled to. You need to keep records to back up your claims, but the Revenue will initially accept your assessment and work out your tax bill using the figures you have sent it (or agree your assessment of how much you owe if you do the sums yourself).

Your tax office will check your tax return for simple errors or omissions, but later it may start an enquiry. If this happens, you may be asked to provide records to back up the information you have provided on your return. See 'Enquiries into returns' in 'Dealing with the Revenue', p6.

WHO FILLS OUT A TAX RETURN?

Self assessment applies only to a minority of taxpayers, as most people have their tax deducted under the PAYE system (see 'PAYE income', p17). Around 8.5 million out of 26 million taxpayers have to fill out a tax return.

The main groups of people that receive tax returns are: self-employed people; company directors; higher-rate taxpayers; people who receive rental or investment income; pensioners with more complex tax affairs; business partners, and trustees or personal representatives.



WARNING
All references to the Inland Revenue guide, helpsheets, tax return and supplementary pages are based on the drafts that were available when we went to press. The Revenue expects the final versions of these to be the same, but there's a chance they may differ.

THE 2001-2002 TAX RETURN

The self-assessment tax return form asks for information on income, tax-allowable deductions and allowances applicable to you for the tax year 6 April 2001 to 5 April 2002. It is customised to your particular circumstances. Everyone who gets a tax return receives the standard ten-page form, which asks for information on income from savings, investments, state benefits and pensions, as well as allowances and reliefs you wish to claim.

FILLING OUT THE FORM

If a box on the return applies to you, you must complete it. Don't just write 'see accounts' or 'see P60' etc. However, if you are unsure about anything, list your queries in a covering letter or telephone your tax office before sending back your return.

Keep a note of your entries, or take a photocopy of the form before sending it back. You can't send your tax office a photocopy of your completed return, but it will accept a photocopy of the actual form, provided you write your answers on the photocopy itself and also sign it. You can also file your tax return on the internet.

SUPPLEMENTARY PAGES

If you have income only from pensions, state benefits and savings and investments, the standard ten-page form will be all you need. However, if you have other types of income, you may also receive supplementary pages. For example, if you are employed, you will also receive the supplementary employment pages – a double-sided form numbered E1 and E2 (see 'PAYE income', p17). If you are self-employed, you'll receive the four-page self-employment supplementary pages – SE1 to SE4 (see 'Self-employment', p28).

Page two of your tax return lists all the supplementary pages that are available. Everyone should read through page two (as it is your responsibility to check you have the correct pages) and tick the boxes that apply. You should complete any supplementary pages first and then work your way through the rest of the tax return.

New income

If you have new income during the tax year that your tax office doesn't know about (for example, if you start letting a property during the tax year), you won't automatically receive the correct ▶

supplementary forms. It is your responsibility to ensure you have all the forms you need. You can order any supplementary forms (and helpsheets) from the Inland Revenue on 0845 9000 404.

The following headings relate to specific sections of the tax return.

INCOME FROM UK SAVINGS AND INVESTMENTS

Complete these sections if you received taxable interest, dividends, income distributions or other taxable investment income (but not overseas investment income). Don't enter tax-free income (from Peps or Isas, say). For more information on what is considered tax free, see 'Savings and investments', p44. If you receive income from more than one investment of the same type, add the relevant amounts together before completing the form. There's a blank form you can use to list your various investments in the Inland Revenue tax return guide.

What do you need to fill in?

If you receive interest from a National Savings Ordinary Account, send your book away to have the interest added. To find out how much interest from other savings accounts you have received, go back through your own records or contact your bank or building society. If you've received interest without having tax deducted, ask for a statement of interest not taxed. You need a record of any interest from other sources, such as British Government stocks.

If you have shares or unit trusts, you need the tax vouchers which come with your dividends and distributions. If they are paid direct to your bank, the tax vouchers may be sent there too. If you received shares in place of cash dividends, you'll need the offer letter showing the 'appropriate amount in cash'.

Interest

On the tax return, it's important to separate interest where no tax has been deducted from interest paid with tax deducted. If you hold joint accounts, enter only your share of the interest. You must also include any investment income not already accounted for from conventional savings and investment sources like banks, building societies and National Savings, such as British Government stocks (gilts). For more about the type of income to enter here, see pages 10 and 11 of the Inland Revenue's guide. If no tax has been deducted, show only the total interest received.

EQUALISATION PAYMENTS

If you receive income or dividends from unit trusts or Oeics, you may have what's called accumulation units or shares. This means the interest or dividend is reinvested in the unit trust or Oeic for you. However this counts as income for tax purposes and must be entered into your tax return as either interest payments or dividends. If you're unsure, speak to your tax office, the self-assessment helpline (0845 9000 444), or your unit trust or Oeic manager. Don't enter any amount shown on your tax voucher as equalisation as this is a repayment of capital and is not taxable.

Dividends

The voucher that accompanies your dividend payment shows the amount you have been paid, and the tax credit. Add together all income received from dividends and add this to the total amount of tax credits to give the total dividends or distributions plus tax credits. Refer to p12 of the Revenue's guide for information on how dividends are taxed.

You must also add together all dividend distributions from UK-authorised unit trusts and open-ended investment companies (Oeics) and enter the total amount received, the total tax credits, and total dividends plus credits. This information is on your dividend vouchers. If you don't have a voucher, ask your unit trust or Oeic manager to send you a duplicate.

There are special rules for equalisation payments and reinvested income – see box 'Equalisation payments', above.

Scrip dividends

Some companies pay out dividends in the form of shares rather than cash. These are usually known as scrip dividends (sometimes as stock dividends) and count as taxable income only if the shareholder has an option to take cash. If so, they should be entered in your tax return.

Your company should send you a statement showing the 'cash' amount. If you have more than one statement, add the amounts together. The notional tax on scrip dividends is an amount equal to one-ninth of the cash amount. A bonus issue of shares is non-taxable except in unusual circumstances.

Non-qualifying distributions

You also need to include details of non-qualifying distributions and loans written off in your tax return. For example, a non-qualifying distribution might be:

- a bonus issue by a company of securities or redeemable shares; or
- the paying on of a bonus received by the company itself.

The total amount of the distribution will be:

- for securities, the amount of the principal secured plus any premium paid for them minus any new consideration (payment) given by you for that issue
- for redeemable shares, their nominal value plus any premium paid for them.

If you are a starting- or basic-rate taxpayer, no further tax is due on these distributions.

If you pay higher-rate tax, an amount of starting-rate tax is treated as already paid by you and set against your tax bill. Multiply this amount by 10 per cent to arrive at the starting-rate tax which is treated as paid by you. If you are

ACCRUED INCOME

When you buy or sell certain stocks (including gilts and permanent interest-bearing shares in a building society), part of the price may include a portion of the next interest payment. This is called accrued income. You may have charges or reliefs for this type of income and should refer to p11 of the Inland Revenue tax return guide for details of what to put where. See also Inland Revenue leaflet IR68.

a participator or associate of a 'close' company and you have had a loan or advance written off, you may have some tax to pay.

The amount written off is treated as income received after deduction of tax at the ordinary dividend rate (10 per cent). If you pay tax at the starting or basic rate, there is no more tax to pay. If you pay higher-rate tax, you will have tax to pay. You calculate this by finding the amount of the loan written off, multiplying this by one-ninth and then adding together the figures.

PENSION AND SOCIAL SECURITY BENEFITS

You need to complete this section if you received a UK pension, retirement annuity or any of the taxable social security benefits shown in the tax return. See p13 of the Revenue's guide for a full list of what's included and excluded. Enter only the taxable part.

You need details of the state pension that you were entitled to during tax year 2001-2002 (ask your Benefits Office for form BR735).

If you receive a pension from a former employer that is taxed under PAYE, you should get a P60.

If you receive any personal pensions, you will need a statement showing how much you've been paid (your pension provider will send you this). If you've been unemployed or if you receive incapacity benefit or other benefits, your Benefits Office will confirm how much of this money is taxable.

State pensions and benefits

As well as the basic state pension, you should include any Serps or graduated pension you were entitled to in 2001-2002, but not any Christmas bonus or winter fuel payment you received as these payments aren't taxable.

Widow's pension or bereavement allowance

Enter the full amount you were entitled to during 2001-2002. Form BR735 from your Benefits Office will give you this information.

Widowed mother's allowance or widowed parent's allowance

If eligible, you should include the flat-rate basic allowance and any earnings-related increase. Don't include anything you receive because you have a dependent child – this isn't taxable.

Industrial death benefit

If you're eligible, then include the annual industrial death benefit pension you are entitled to. Don't include industrial death benefit child allowance as this isn't taxable.

Jobseeker's allowance

If you receive jobseeker's allowance, enter the taxable portion of the benefits. The Department of Work and Pensions will give you form P60U by 31 May 2002.

Invalid care allowance

Put in the full amount of invalid care allowance you were entitled to for 2001-2002 and include any addition for a dependent adult. Exclude any addition for a dependent child as this isn't taxable.

Statutory sick pay and statutory maternity pay

These benefits are usually paid to you by your employer and will be included in your P60 or P45. If so, include them under income from employment, not in this section. If the DSS has paid these benefits, enter the amount you received during 2001-2002.

Incapacity benefit

Enter only the taxable portion of any incapacity benefit you receive and any tax already deducted. The Department of Work and Pensions will give you a P60 (IB) by 31 May 2002 to confirm the details.

Other pensions and retirement annuities

For this, total up all other pensions you received, provided the payer is based in the UK. Include amounts from ex-employers' schemes, personal pensions, retirement annuity contracts or free-standing additional voluntary contributions.

If you have deferred taking a pension but have opted for the income withdrawal option instead, put the total amount you received during the tax year. If you receive more than one pension, keep separate records but total them up for the tax return.

The taxable amount of your pension may be reduced if it qualifies for a deduction. This applies to some UK pensions awarded to former employees for injury at work, or to individuals employed by an overseas government.

GAINS ON LIFE POLICIES OR SURPLUS FUNDS FROM AVCS

You will need to complete this question if you had a chargeable gain on a UK life insurance policy, life annuity or capital redemption policy; or received a refund of surplus contributions for a free-standing additional voluntary contribution scheme.

Gains on UK life policies

If you have made a gain on a life insurance policy (also known as a 'chargeable event'), you need a chargeable event certificate – the life insurance company will provide this. Profits on these policies (typically, life insurance bonds – also known as single-premium, guaranteed growth, and guaranteed income bonds) are called chargeable gains.

However, for tax purposes they are treated as income, not capital gains. Most gains are treated as though basic-rate tax has been ▶

deducted before you receive it, so starting- and basic-rate taxpayers have no further tax to pay. Higher-rate taxpayers have a further 18 per cent to pay. However, there are exceptions, notably gains on certain life annuities and friendly societies' tax exempt life insurance policies.

Some questions ask you to give the number of years you've held the policy. In most cases this means the number of years from the commencement date of the policy to the date of the chargeable event, but see p16 of the Inland Revenue's guide and IR320 *Gains on UK life insurance policies* before entering this information.

If you subscribed to more than one life insurance Isa during the 2001-2002 tax year, the most recent policy will be 'voided', which means any gains become liable for tax. Your Isa manager will have told you if this applies to you and sent you a certificate which confirms the amount of gain and the tax paid. This must be entered in the tax return.

Corresponding deficiency relief is occasionally granted when a life insurance policy, life annuity contract or capital redemption policy comes to an end. See helpsheet IR320 for further details.

Surplus funds on AVCs

If you received a surplus of additional voluntary contributions, your pension provider will provide the necessary tax certificate, which will show the amounts to enter.

OTHER TAXABLE INCOME

You need to fill in this section if you have income from another source that doesn't come into any of the categories covered in the tax return or supplementary pages. For more information, see Inland Revenue helpsheet IR325 *Other taxable income* and p17 and p18 of the Inland Revenue's guide.

CLAIMING RELIEF FOR PENSION CONTRIBUTIONS

You will need to complete this section if you:

- are self-employed and make contributions to a personal pension plan, a stakeholder pension and/or a retirement annuity contract
- are an employee, don't belong to an employer's pension scheme, and contribute to a personal or stakeholder pension plan
- are an employee, belong to your employer's pension scheme and also make contributions to a personal pension, stakeholder pension or retirement annuity because you have earnings from, say, a part-time job
- are an employee, belong to your employer's pension scheme but also pay money in to a free-standing additional voluntary contribution scheme or stakeholder pension.

You need to know all the basic details of your pension scheme(s) – what type of scheme it is, how much you paid, and whether you paid net or gross. Contact the company to which you pay your premiums. You also need an estimate of how much you'll pay in 2002-2003. If you want to use the carry-back rules for pension payments, see 'Saving for your retirement', p53, or Revenue helpsheet IR330.

Retirement annuity contracts

These are old-style personal pension plans taken out before 1 July 1988. Enter the total paid to all policies during 2001-2002. If you have already claimed tax relief on premiums paid during 2001-2002 in an earlier year, enter the amount already claimed. Then enter any amount to be treated as paid in previous years (carry back).

If you paid a contribution after 5 April 2002 and want to claim tax relief for this during 2001-2002, enter this amount. Enter the total amount you are claiming relief for in this tax year as 'relief claimed'.

ROUNDING UP AND DOWN

When filling in details of income on your return, round down each total to the nearest pound – so for £12.95 enter £12. When you enter outgoings, round up the figure in each section to the nearest pound – so for £387.01, enter £388. You can also round up tax credits and tax deductions. If an entry in a particular box requires income and credits from various sources to be added together, it is the aggregate figure that should be rounded. If you produce a return on a computer, make sure the Revenue has approved the design and wording, and check whether precise figures should be entered or whether the program can deal with rounded figures.

Personal and stakeholder pensions

In previous years, different rules applied to contributions from employees and the self-employed, but now there's a single regime for personal and stakeholder pension contributions. Enter the total gross amount paid to all the policies in this category during 2001-2002. Do not include any contributions paid by your employer. You pay your contributions to your pension scheme administrator net of basic-rate tax, therefore you need to gross up your contributions by dividing your payments by 78 and multiplying by 100. For example, if you pay £100 a month, a gross amount of £128.20 is actually allocated to your policy. Refer to p20 of the Inland Revenue's guide. Enter details of payments in the same way as for retirement annuity contracts.

Contributions to other pension schemes

If your employer has not already deducted a payment to its pension scheme from the income you've shown on employment page E1, enter the amount to be deducted here. This will apply only rarely since these contributions are usually deducted from your pay by your employer before showing your pay on your P60. You must also include any amounts you paid to a free-standing additional voluntary contribution scheme. You pay premiums net of basic-rate tax but

you must enter the gross amount – see 'Personal and stakeholder pensions', left.

OTHER RELIEFS

Fill in this question if you:

- paid interest on loans that qualify for tax relief (not your main home). See helpsheet IR340 for examples
- made enforceable alimony or maintenance payments and you or your former husband or wife were born before 6 April 1935
- subscribed to Venture Capital Trust shares or the Enterprise Investment Scheme
- made a donation to charity through Gift Aid, or a covenant entered into before 6 April 2000
- made gifts of qualifying investments to UK charities. One-off payments should be separated out and included in the separate box provided
- had expenses relating to a business that is no longer trading
- made payments to an annuity or covenant to your trade or profession for genuine commercial reasons and you are a higher-rate taxpayer
- made trade union subscriptions that entitle you to a pension benefit or life insurance or funeral benefits, or if you pay premiums to a friendly society for a combination of sickness and death benefits
- made payments to an employer's compulsory widow's, widower's or orphan's benefit scheme
- wish to claim higher-rate relief on a qualifying distribution on the redemption of bonus shares or securities.

See pages 22 to 25 of the Revenue's tax return guide for full details of these reliefs.

ALLOWANCES

Question 16 deals with the allowances you were entitled to claim during the 2001-2002 tax year. Everyone is entitled to a personal allowance of £4,535 for the 2001-2002 tax year. If you were born before 6 April 1937 you may be entitled to claim a higher age-related personal allowance. Give your position as it was on the last day of the tax year (5 April 2002).

Blind person's allowance

In England and Wales you must be registered blind with a local authority to be eligible for the blind person's allowance. You are not eligible if you are partially sighted rather than blind. In Scotland and Northern Ireland, you qualify for the blind person's allowance if you are unable to perform any work for which eyesight is essential.

If your income is not sufficient to use up your allowance, any spare blind person's allowance can be transferred to your spouse, whether or not he or she is blind, provided that you lived together at any time in the 2001-2002 tax year.

The blind person's allowance was £1,450 for 2001-2002. If this is the first year that you are registering for the blind person's allowance, put the date of registration into the relevant box. Whatever year you registered, you must also enter the name of the local authority, or enter 'Scottish or Northern Ireland claim'.

Married couple's allowance

This allowance was abolished with effect from 6 April 2000 unless either you or your husband or wife were born before 6 April 1935. In other words, you must have reached the age of 65 before 6 April 2000. If both you and your husband or wife were born after 5 April 1935, you cannot claim, so don't complete this part of the tax return form.

The married couple's allowance goes automatically to the husband unless either of you has asked for half the allowance, or you have both asked for the whole allowance to be given to the wife. You can only change the way married couple's allowance is given if your tax office agrees to the change before the beginning of the tax year. It is too late for a change to be made for the 2001-2002 or 2002-2003 tax years, but you can have the change made for the 2003-2004 tax year if you write to your tax office before 6 April 2003.

If you are a married man or a married woman claiming half or all of the married couple's allowance, fill in the relevant boxes. If you were born before 6 April 1935, enter your date of birth. Only complete the other box if your spouse was born before 6 April 1935 and is older than you.

If you are a married man claiming the allowance, you can only claim married couple's allowance if you or your wife were born before 6 April 1935 and you lived with your wife for all or part of the year ended 5 April 2002. Even if you were not living together under the same roof, you can be regarded as living together as long as you are still married and neither of you intends to make the separation permanent.

The procedure for married women claiming the allowance is almost identical, but you must also have already elected that half or all of the allowance should go to you.

Children's tax credit

Children's tax credit (CTC) is a new tax relief introduced from 6 April 2001 for people with at least one child aged under 16 living with them (see 'You and your family', p57, for further details). Even if you've already filled in a claim form and received tax relief through your PAYE code, you should still fill in this section. You cannot claim both CTC and the married couple's allowance.

A family can claim only one CTC tax credit between them, regardless of the number of children. If neither partner pays higher-rate tax, then normally the CTC will go to the partner with the higher income – tick 16.20 or 16.21 to indicate who has the higher income. However, the couple can agree to split the ▶

credit between them, or if the couple elected before the start of the tax year, the whole of the CTC entitlement can go to the partner with the lower income. Make your choice by ticking one of boxes 16.23, 16.24 or 16.25. If the person who receives the CTC does not earn enough to use all the allowance, they can transfer the unused credit to their partner.

If either or both partners pay higher-rate tax, the partner with the higher income must claim the credit. There is no option to share the credit, or transfer it to a partner. This is to ensure the CTC reduction is calculated on the person with the higher income.

Transfer of surplus allowances

Complete this if your income is less than the allowances due and you are transferring any surplus married couple's, blind person's allowance or CTC to your husband or wife. You will also need to complete this if you are claiming surplus allowances.

STUDENT LOANS

The tax return asks whether you are liable to make any repayments of student loans for the 2001-2002 tax year. Repayment of the new type of student loan made to a new borrower from August 1998 is collected by the Inland Revenue. The amount of the loan repayment for any year depends on your income. Your student loan company should have notified you if repayment of the loan commenced during the year ended 5 April 2002. If you are calculating your own tax, you will also have to work out the student loan repayment due and enter the amount in the tax return.

CALCULATING YOUR TAX

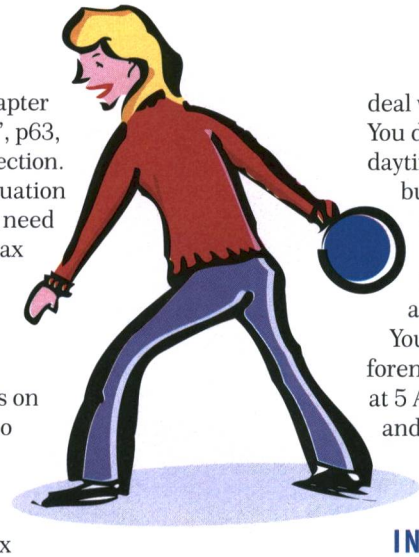
Doing it yourself

If you wish to do your own tax calculation, fill in the relevant section of the form. If you don't, then go to the next section.

You'll need to refer to the tax calculation guide that came with your tax return. The chapter 'Check your income tax', p63, will also help with this section.

As well as your tax situation for 2001-2002, you will need to refer back to earlier tax years if you still owe back-tax or if unpaid tax is being collected through your tax code.

If you make payments on account, you will have to include any payments already made for the 2001-2002 tax year when calculating the tax you owe. You also need to calculate the payments on account for 2002-2003. See 'Payments on account', p37, for further information.



Letting the Revenue do it

If you decide not to calculate your own tax and you miss the 30 September deadline, the Revenue will still do it for you, but it will not guarantee to let you know about any tax you owe by the final deadline of 31 January 2003. This might mean that you incur surcharges and interest.

CLAIMING A TAX REFUND

There is a section of the form which asks you whether you want to claim a repayment if you have paid too much tax. If you tick 'no', any tax overpayment will be offset against a future tax bill. If you are not claiming a repayment, ignore the rest of this section.

If you answer 'yes', you should fill in the boxes if you want the refund to be sent to you (or to a bank or building society account, or to your agent).

TAX ALREADY REFUNDED

The next section asks whether you have already had a refund of tax or had tax offset by either the Inland Revenue or your Benefits Office for the 2001-2002 tax year. Answer yes or no as appropriate.

PERSONAL DETAILS

Everyone must complete this section as it helps your tax office to deal with your tax affairs promptly. You don't have to enter your daytime telephone number here, but it might save time if your tax office has any queries about your return. Alternatively, you can give your agent or adviser's details.

You must give your first two forenames, your marital status as at 5 April 2002, your date of birth and your National Insurance number.

ADDITIONAL INFORMATION

These are a few final questions, some of which relate to the next tax year. Everyone should read through these questions and check whether any of the boxes apply to you. These cover the following circumstances:

- if you don't want any tax you owe to be collected through your tax code
- If you can give only provisional figures on your tax return
- if you are claiming relief now for 2002-2003 trading losses, or certain capital losses. Enter the amount of the loss and year for which you are claiming relief in the 'Additional information' section
- if you want business receipts received after a business has ceased trading to be taxed as income of an earlier year. You also need to tick this box if you have literary or artistic income which you want to spread back to previous years or forward to a future year. Give as many details as possible of your claim under the 'Additional information' section.

DECLARATION

Before you send your form back, you have to declare that the information contained in it is correct and complete. You must also fill in this section if you are signing on someone else's behalf – for example, as an executor, trustee or receiver. Give the name of the person you are signing for, and your name and address in the 'Additional information' section.

AND FINALLY...

Before you send off your tax return:

- make sure that you have signed and dated it
- make sure you've filled in all the relevant sections and supplementary pages
- remember to take a photocopy of the form and anything else you're sending with it.
- Be warned – you can be prosecuted for knowingly filling in the return incorrectly.

Supplementary pages

People who have income other than from savings, investments, pensions or state benefits may need to complete more than the basic tax return.

There are various extra pages to the tax return, known as supplementary pages, which you may have to complete depending on what type of income you have. Eight sets of pages cover the most common types of income (see below) and you may have to complete one or more of these.

Elsewhere in this guide we explain in detail the supplementary pages that cover income from employment and self-employment.

In this chapter we give a brief summary of the six other main supplementary pages.

In addition to the supplementary pages mentioned here, there are other pages that cover partnerships, Members of Parliament, Lloyd's Underwriters and Ministers of Religion. We haven't covered these in our guide, but helpsheets and notes about them are available from the Inland Revenue orderline (0845 9000 404).

EXTRA PAGES

- **EMPLOYMENT** if you work for an employer or are a director
- **SELF-EMPLOYMENT** if you work for yourself
- **CAPITAL GAINS** if you made gains on a sale or gift
- **PROPERTY** if you had income from letting property or land
- **FOREIGN** if you received income from abroad
- **NON-RESIDENCE** if you're not liable to tax because of residency
- **SHARE SCHEMES** if proceeds from a scheme are taxable
- **TRUSTS ETC** if you are liable for tax under the terms of a trust.

FOREIGN

These five pages (F1 to F5) cover all types of income you receive from abroad. You should include any savings and investment income, such as dividends from overseas companies or interest from offshore bank or building society accounts. The foreign pages also cover income from overseas trusts, pensions, land or property you let overseas, and gains on overseas assets.

You'll need to get together any dividend vouchers received in respect of overseas shares you own; bank statements for overseas accounts; overseas pension advice notes (if you get a pension from abroad); and any foreign tax assessments. You should also collect up receipts for any tax you may have already paid on some of this income in the country of origin, as you will need to declare any tax paid on these pages. The pages aren't easy to navigate, which might explain why there are 28 pages of notes produced by the Inland Revenue to help you. If you're struggling with them, we suggest you contact either your own tax office or a local tax enquiry centre for help.

NON-RESIDENCE

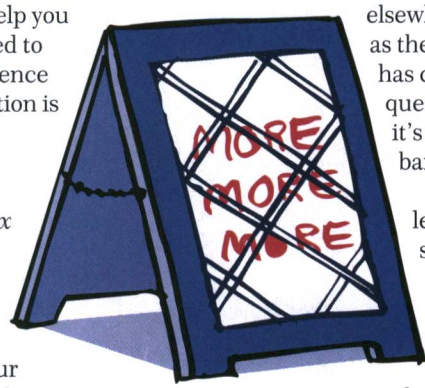
Complete pages NR1 and NR2 if any of the following applied to you during the 2001-2002 tax year:

- you were not resident in the UK. Broadly, you are UK resident if you spent at least half of the tax year here, or if you regularly spend at ▶

least a quarter of each tax year here
- you were not ordinarily resident in the UK. The term 'ordinarily resident' means you are resident in the UK year after year
- you were entitled to 'split-year' treatment. This might apply if you came to or left the UK partway through a tax year
- you were not domiciled in the UK. Many factors affect your domicile but the country where you have a permanent home is normally the one where you are domiciled.

Special rules apply to some people working abroad, such as Crown employees, civil servants and members of the armed forces, and also to members of visiting forces who are posted to the UK.

The Inland Revenue notes on non-residence contain questions and answers that will help you decide whether you need to complete the non-residence pages. Further information is available in the Inland Revenue booklet IR20 *Residents and non-residents: liability to tax in the UK.*



SHARE SCHEMES

If you received shares free or cheaply from your employer, or exercised share options, tax may be due for the 2001-2002 tax year. If so, you have to complete the supplementary pages for share schemes. The tax rules differ depending on whether your share scheme is Revenue approved or not. Under approved schemes, exercising an option won't normally be classed as a 'taxable event', unless by exercising the option you have broken certain conditions. The Revenue notes on share schemes explain when tax is due on these schemes, or you could check with your employer or tax office.

Page S1 of the share schemes supplementary pages summarises all taxable events for the tax year from different schemes. However, if you have more than one taxable event during the year, you must fill in a separate copy of pages S2 and S3 for each event. You can photocopy pages S2 and/or S3 or telephone the Revenue orderline for more copies.

TRUSTS ETC

Complete these pages if you received (or were regarded as receiving) any income during 2001-2002 from a trust, settlement, or the estate of a deceased person. Check with the trustees or personal representatives of the deceased if you are unsure whether you need to complete these pages.

Don't include income from a trust where you have an absolute right to the income and capital (known as a bare trust.) This income should be included elsewhere in the tax return (such as the foreign pages if the income has come from overseas, or under question 10 of the tax return if it's come from UK dividends or bank accounts).

If all you received was a legacy consisting of a fixed sum of money or a specific asset, you don't have to pay tax on it and there is no need to fill in these pages.

However, if your legacy was paid with interest (possibly because there was a delay in paying it to you), you should include the interest in box 10.14 on page 3 of the main tax return.

LAND AND PROPERTY

Anyone who receives income from letting land or property must fill in these supplementary pages.

This applies whether you run a rental business with several properties, or have just one property you let out. People who let out furnished holiday homes and those who take lodgers into their homes must also complete these pages.

The first question on the first page (L1) asks whether you are claiming 'rent-a-room' relief, which you can claim if you let rooms in your only or main home and the rent you receive is less than £4,250 (or £2,125 for shared claims). If you answer 'yes' and this is your only income from land or property, the income is tax free and you can ignore the rest of the land and property pages. See 'Income from property', p34, for more details of rent-a-room.

Furnished holiday lettings have their own section in the land and property pages – all other rental income goes (unsurprisingly) into a section called 'Other property income'.

CAPITAL GAINS

If you made any capital gains during the 2001-2002 tax year, you must fill in the capital gains pages. However, you won't have to fill in these pages if:
- the gain arose from disposing of your only or main residence; and
- other assets you disposed of during the tax year were worth £15,000 or less in total; and
- your chargeable gains (before losses and taper relief) were £7,500 or less

There are eight capital gains pages, although you may not have to complete all of them. The pages you complete depend on the type of disposals you make during the tax year. Page CG1 is for taxpayers who have straightforward transactions involving only quoted shares or securities. Fill out page CG1 and ignore CG2 to CG6 if:
- all the transactions you undertook in 2001-2002 involved quoted shares or other securities; and
- taper relief is not available to reduce any of the gains; and
- you aren't claiming tax reliefs, other than indexation allowance, which may reduce your gains.

See the Inland Revenue's notes on capital gains, page CGN14 and CGN17, or 'Capital gains tax', p47, for more information on indexation allowance and taper relief.

If these conditions don't apply, ignore CG1 completely and fill out CG2 to CG6.

PAYE income

Most employers deduct tax from your salary before they pay it, under the Pay As You Earn (PAYE) scheme. Income from a company pension is also usually taxed under PAYE. Here we explain how it works.

It is still possible to be paying the wrong amount of tax even if you are within a PAYE scheme. Always check your PAYE code and make sure you are claiming the right allowances.

PAYE CODES

The Revenue gives employers a PAYE code for each employee (or pensioner), which tells them how much tax to deduct. Your coding notice, together with your payslip or pension notification, is the key to ensuring that you pay the right amount of tax.

Most PAYE codes consist of a number followed by a letter (see 'What PAYE codes mean', p18). The number tells your employer how much tax-free pay you're allowed in each tax year. The letter means that employers can alter code numbers for some employees automatically, in line with any Budget changes.

The number is arrived at by working out the allowances and reliefs to which you are entitled. An amount is taken off for taxable benefits or other income you get, such as a state pension.

The final result is the amount of tax-free income to which you are entitled in the tax year. This is converted to your PAYE code by removing the last digit and adding the relevant code letter.

To work back from your code to your tax-free pay, just put a 9 on the end of the number (the knocked-off figure is always assumed to be 9). So if, say, your code is 461L, you can earn one-twelfth of £4,619 (£385) free of tax each month.

If your deductions, such as fringe benefits, exceed your allowances and reliefs, then your code begins with a K. The excess over your allowances (shown by the number part of your code) is added to your pay for tax purposes.

MORE HELP

Inland Revenue leaflets

IR33 Income tax and school leavers
IR34 PAYE
IR41 Income tax and job seekers
IR60 Income tax and students
IR121 Income tax and pensioners

YOUR CODING NOTICE

A coding notice gives details of how your PAYE code is worked out. You won't necessarily get one each year, especially if your tax affairs are straightforward. The Inland Revenue usually sends out most notices in January or February to apply from the start of the next tax year (6 April).

The Revenue may send you a notice if you query your code, if your circumstances change, or if there is a change in tax rules.

Allowances

We've shown an example coding notice overleaf. Entries on the left under 'Your tax allowances' (such as your personal allowance) increase the amount of tax-free pay to which you're entitled.

If you are 65 or over, you may see an estimate of your total annual income described as 'Estimated Income'. This is used to calculate age-related allowances (which ▶

depend on your income – see p41). Tax-allowable payments that qualify for relief may also be shown. The figure on the coding notice is the amount your tax office expects you to pay in the coming tax year (for example, if pension premiums are given, it will assume that you're paying the same as last year). Possible entries include:

- payments for allowable expenses incurred in your job, and professional subscriptions that are essential for your work
- payments to personal pension (including stakeholder plans) or old-style pension plans (retirement annuity contracts) and payments to free-standing additional voluntary contribution schemes
- tax-allowable payments to charity.

With some payments, such as those to personal and stakeholder pensions and charitable gifts, you receive basic-rate tax relief by paying less to start with. If so, there will be an entry only if you are a higher rate taxpayer.

Restricted allowances

Some 'restricted' allowances don't qualify for full tax relief. Instead, a percentage of the allowance is deducted from your tax bill. Married couple's allowance and maintenance relief are examples of restricted allowances and still apply if either partner to the marriage was born before 6 April 1935. If you are one of the people eligible for a restricted allowance, the full amount of the allowance is shown on the left-hand side of your coding notice and an adjustment called 'Allowance Restriction' is given on the right-hand side.

The new children's tax credit is another example of a restricted allowance. This can be claimed by single people and couples (whether married or not) of any age if they have a child under 16 living with them. The full amount of the credit is given on the left-hand side of your coding notice, and an entry called children's tax credit restriction is on the right. To check the relief you've been given, deduct the restriction from the full allowance and multiply the result by your highest rate of tax. The answer should be within a few pounds of the relief that's due. The actual relief due on all restricted allowances is currently 10 per cent of the allowance. So, as the children's tax credit was £5,200 in 2001-2002, the tax bill of eligible families was reduced by up to £520.

Deductions

Entries shown in the right-hand column reduce your allowances so that you get less tax-free pay. They include:

- most fringe benefits from your job, such as private medical insurance or a company car
- other income from working that is not taxed under PAYE, such as part-time freelance earnings or commission
- taxable state pensions and benefits
- investment income received before tax (see p44)
- taxable rental income.

If you owe tax from a previous year and it is not being collected in one payment, it will appear as tax underpaid. This reduces your code sufficiently for you to pay extra tax equal to the amount you owe.

If you are a higher-rate taxpayer, the additional tax you owe on investment income is collected under the heading 'Higher-rate adjustment'.

WHAT PAYE CODES MEAN

L	You get the basic personal allowance
H	You get the basic personal allowance plus the full children's tax credit and you are likely to pay basic-rate tax
A	You get the basic personal allowance and one half of the children's tax credit and you are likely to pay basic-rate tax
P	You get the full age-related personal allowance for someone aged 65 to 74
V	You get full age-related personal allowance for someone aged 65 to 74 and full married couple's allowance for those born before 6 April 1935 and aged under 75 and you are likely to pay basic-rate tax
Y	You get full age-related personal allowance for someone aged 75 or over
K	You get this if the total deductions, such as fringe benefits, exceed your allowances. The excess is added to your income each pay period
T	This is used if your tax office needs to review your tax code. You can also ask your tax office to use this code if you don't want your employer to know personal details
DO	All your earnings at this source are taxed at the higher rate, and all your allowances allocated elsewhere
BR	All your earnings at this source are taxed at basic rate and all your allowances have been given elsewhere
NT	You pay no tax on this income

WRONG CODES FOR COMPANY CARS

The two million company car drivers in the UK should pay particular attention to their PAYE coding notices when they come dropping on the mat.

Most people with company cars will see the tax they pay on this benefit either go up or down – but almost certainly change. This is because from April 2002 a new method of taxing company cars, based on the amount of CO_2 emissions a car makes, comes in. It replaces the old scheme that was based on business mileage. We've described this in detail in 'Fringe benefits', p23, and in 'Gas tax for company cars', *Which?*, February 2001, p36.

About a year ago, the Inland Revenue asked employers to give them data on their employees' cars so that they could start calculating company car holders' new tax codes. Unfortunately, however, only about 10 per cent of employers did this, and consequently many coding notices have gone out incorrectly.

If you have a company car, you should have received a new coding notice giving the taxable value of this benefit for the 2002-2003 tax year. Check this using the information on p26 and the table in the February issue of *Which?*, p36. If you think your coding notice is wrong, contact your tax office straight away.

CODING NOTICE

Alice Springs received her coding notice in February 2002 for the 2002-2003 tax year. Because not all of the tax rates and allowances for the year were known at that time, she will get an updated notice after the 2002 spring Budget if she is affected by Budget changes.

On the left-hand side is Alice's personal allowance (the amount she can receive in income before paying tax) of £4,615 and the children's tax credit of £5,200. The personal allowance figure for the 2002-2003 tax year was announced in the November pre-Budget statement. However, the new rate for children's tax credit won't be announced until the Budget later this month, therefore the figure shown is the same as for tax year 2001-2002. Alice currently claims the full amount of the tax credit herself, although as Alice's partner is also a basic-rate taxpayer, the credit could be split between them (see p27 for more information).

The two allowances shown on the left-hand side of the coding notice are added together to give her total allowances of £9,815 at the bottom.

The right-hand side of the coding notice shows any amounts that must be deducted from Alice's allowance. The amount called 'taxable expenses payments' relates to the taxable portion of the payment Alice receives from her employer for using her own car for work. The figure next to 'children's tax credit rest'n' (which stands for restriction) adjusts the tax relief on the £5,200 children's tax credit, so that only 10 per cent of the credit is given against tax (£520). Alice can check this figure is correct by using the following formula. First take the amount given as a restriction from the actual amount of the allowance or tax credit. Then multiply the answer by your highest rate of tax. The answer should more or less equal the actual amount of tax relief due – which in this case is 10 per cent of £5,200 – £520. Alice is a basic-rate taxpayer, so her calculation is: £5,200 – £2,830 (the figure given on her coding notice) = £2,370 x 22% = £521.

The deductions on the right-hand side of the coding notice are taken away from the allowances on the left-hand side and the result is the amount of income Alice is allowed to receive in tax year 2002-2003 before she pays tax – £6,095. The first three numbers make up her tax code (609). Because she gets the basic personal allowance plus the children's tax credit, Alice gets an H code: 609H.

Inland Revenue

PAYE Coding Notice

This form shows your tax code for the tax year 2002 - 03

Please keep all your coding notices. You may need to refer to them if you have to fill in a Tax Return.

155018 003293 AA 003293

120/1

MS A SPRINGS
100 ACACIA AVENUE
NEW TOWN
MIDSHIRE
MD9 1AB

ZOE BLACK
MIDSHIRE 1
CROWN BUILDINGS
NEW TOWN
MD9 9BC

Inland Revenue office phone	Date of issue
01234 567890	6 FEB 2002

Please quote your Tax reference and National Insurance number if you contact us

Tax reference	National Insurance number
222/A900	AB 12 34 56 Z

Your tax code for the year shown above is **609H**

This tax code is used to deduct tax payable on your income from

ANY OLD BUSINESS LTD

If you move to another job, your new employer will normally continue to use this tax code.
The tax code is worked out as follows:

The *See note* columns below refer to the numbered notes in the guidance leaflet P3: Understanding Your Tax Code. Leaflet P3 also tells you about the letter part of your tax code.

Check that the details are correct. If you think they are wrong, or you have any questions, contact your Inland Revenue office (details above).

This coding notice replaces any previous notice for the year. You should pass it to your tax adviser if you have one.

See note	Your tax allowances	£
01	PERSONAL ALLOWANCE	4615
04	CHILDREN'S TAX CREDIT	5200
	Total allowances A	9815

See note	Amounts taken away from your total allowances	£
30	TAXABLE EXPENSES PAYMENTS	890
35	CHILDREN'S TAX CREDIT REST'N	2830
	Total deductions B	3720

C Your tax free amount for the year is £ 6095 , making your tax code 609H *See example overleaf*

PREVIOUS TAX CODE 617H

If necessary we will use this box to give you further information about your tax code

YOUR CODE HAS BEEN ADJUSTED FROM THE INFORMATION GIVEN ON THE FORM P11D SUPPLIED BY YOUR EMPLOYER

P2(T) BS 06/01

SPECIAL CASES

When you start or return to work, change jobs or stop work, your income is likely to change – and you may find that you pay the wrong amount of tax.

Your first job

Your employer should give you form P46 to complete. If you earn £87 a week or more in 2001-2002 (£89 a week in 2002-2003), this is sent to your tax office, otherwise the employer keeps the form. Form P46 enables your employer to tell the Revenue about your job and to work out which PAYE code to use.

If this is your first regular job since full-time education, and you haven't been receiving jobseeker's allowance, you will be given an 'emergency' tax code (461L for the 2002-2003 tax year). This assumes that the only allowance you are entitled to is the personal allowance. You can therefore earn one-twelfth of the personal allowance each month of the tax year before paying tax.

Tax won't be deducted until the tax-free pay you were entitled to in the months that you weren't working has been used up. So, if ▶

you are on code 461L during this tax year, and your first monthly pay day is in the fourth month of the tax year, you are entitled to earn £1,540 (one-twelfth of £4,615 x 4) before tax starts to become due.

If you've worked before

When you change jobs, your previous employer should give you form P45. This shows your PAYE code and the tax deducted from your total pay for the year to date. Give it to your new employer so the correct amount of tax can be deducted from your pay.

If you don't have a P45 or can't give one to your new employer, you will be given form P46 as for your first job. Until the Revenue sorts out your code, your employer will usually operate the emergency code on a 'week one' or 'month one' basis. This works as though each week or month is the first one of the tax year, and no account is taken of any free-of-tax pay due from the beginning of the tax year to the time you started working. You may pay too much tax for a while, but when the Revenue allocates your proper code, your employer will refund any overpayment.

Income less than expected

Because your tax-free pay is spread over the tax year, if you earn less than this amount in any pay period (because of sickness, for example, or unemployment), you will pay too much tax. Your employer or Jobcentre normally refunds this automatically. Contact your tax office if this doesn't happen.

If you're off work

Sick pay from your employer (including statutory sick pay) is normally taxable, and the tax is collected through PAYE. But if the amount you have received is less than the tax-free pay to which you are entitled, you will receive a refund of tax already paid in addition to the sick pay.

Statutory maternity pay and any maternity pay from your employer are also taxable through the PAYE system. The state maternity allowance, however, isn't taxable.

If you're unemployed

You may become unemployed before you have used up all of the tax-free pay. If so, any unused entitlement will be set against the taxable amount of any jobseeker's allowance or income support you receive. When you stop claiming benefit, or at the end of the tax year if this is first, the Jobcentre will work out your tax position. It will send you a refund if you have paid too much tax.

Your former employer should give you a P45 if you become unemployed; give this to the Benefits Office. The Jobcentre needs the information to work out whether you will get a tax refund when you stop claiming jobseeker's allowance or at the end of the tax year. Don't be put off claiming just because you don't have a P45. If you're still not working at the end of the year, you'll get a P60U, which gives details of all the taxable benefits that you've received and the tax you've paid. When you find a job, fill in the form in the back of booklet ES40 (which explains about signing on) and return it to the Jobcentre, which will give you a P45. If you've paid too much tax, the Jobcentre or your new employer will give you a refund.

EXPENSES

The expenses boxes tell the Revenue the amounts you are claiming for different types of expenses. These may be different from the amounts you've been paid. You need to complete these boxes as well the earlier one that covers the total payments made to you in respect of expenses (but, as with that box, don't include expenses covered by a dispensation your employer might have).

The Revenue's notes and booklet 480 *Expenses and benefits. A tax guide* give the expenses you can claim without having to pay tax. But generally, the expenses you can claim ☑ and those you can't ☒ are as follows:

☑ Replacing, cleaning, and repairing protective clothing and uniform necessary for your job, and which you are required to buy; cleaning this clothing if it's bought by your employer and no facilities are provided.

☒ Ordinary clothes you could wear outside work.

☑ Maintaining and repairing factory/workshop tools and instruments you're required to provide; replacing tools and instruments (less any amount from sale of old ones), provided that the new ones are not inherently better than the old.

☒ The initial cost of instruments and tools – but you may be able to claim capital allowances.

☑ Reference books necessary for your job that you're required to provide (if the book's useful life is over two years, you may have to claim capital allowance instead); stationery that's used strictly for your job.

☒ Books useful, but not necessary, for your job; stationery that is not used strictly for your job.

☑ Fees and subscriptions to professional bodies; fees to keep your name on a professional register approved by the Revenue – but only if this is a condition of your employment.

☑ Expenses relating to entertaining customers, but only if you can claim these expenses back from your employer, or pay them out of an expense allowance given specifically for entertaining; expenses incurred strictly in the course of doing your job.

☒ Other entertainment expenses.

☑ Reasonable hotel expenses when you have to travel because of your job (if you have a permanent home).

☒ Travel to and from your place of work.

☑ Use of home for work. If the nature of your employment would require any person holding it to carry out some part of the duties at home, then you can normally claim a proportion of the heating, lighting and cleaning costs as well as the cost of business telephone calls. These expenses are allowed only if it is necessary that you carry out some of your duties at or from home (if, for example, it is an express or implied condition of your employment).

☒ A proportion of mortgage interest, property insurance or water rates.

☑ Interest on loans to buy equipment necessary for your job; part or all of the interest on a loan to buy a car for business use.

☒ Overdraft or credit card interest.

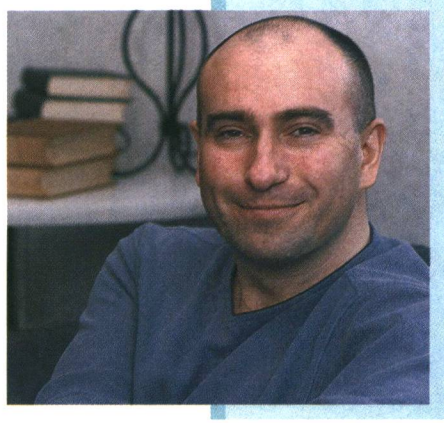
☑ Car running costs within certain limits. You can claim the whole cost if you use your own car only and necessarily to do your job. You can claim a proportion of the cost if you use it privately as well. If your employer requires you to use your own car for business purposes, and you're paid less than it costs you, claim the extra cost up to the maximum allowed. If you pay for the running costs of a company car, claim a proportion of the cost for business mileage. See Inland Revenue booklet IR125 *Using your own car for work*.

New allowances or outgoings

Your code may change if you become entitled to a new allowance or incur a new outgoing during the tax year (such as pension payments or gifts to charity). Tell your tax office and ask for a new code, otherwise you may pay too much tax, which will have to be refunded.

Also tell your tax office about any change that might reduce your code – for example, if you stop making contributions to a pension plan on which you get tax relief through the PAYE system. If you don't, you will have more tax to pay later on.

PAYING TAX ON FREELANCE INCOME



Pete Tynan works full time and is taxed through the PAYE scheme. He's just done some freelance work, but his current tax code reflects only his full-time job. If Pete doesn't tell the Revenue about his freelance earnings, then he'll be underpaying tax. Pete came to us to find out what to do.

From our tax calendar (p4) we can see that Pete has until 6 October 2002 to inform the Revenue of new untaxed income relating to the 2001-2002 tax year. He needs to get the number of his tax office from his employers and call them to explain the situation. His tax office will then work out how much he owes. It's important to note that the tax office has the final say over how he pays the money back. It can insist that Pete fills in a tax return, which Pete isn't keen on. However, as this is likely to be Pete's only freelance earnings for the tax year, the tax office may decide to collect the tax via PAYE or a cheque.

More than one job

If you have two or more jobs, you'll have a separate tax code for each. Personal allowances will be given against what you, or your tax office, regard as your main employment.

Your gross pay from your second job will probably all be taxed at the basic rate (or 40 per cent if you are a higher-rate taxpayer). Don't worry if this results in any under- or over-payment of tax for the year as a whole – an adjustment will be made at the end of the tax year.

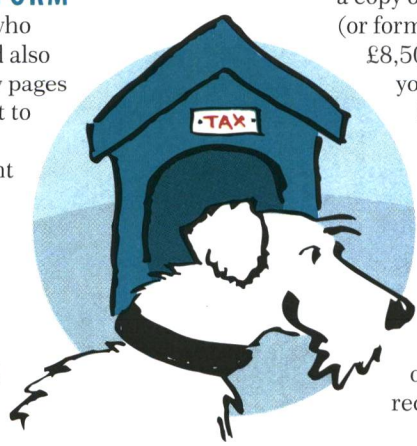
However, there is a different system if you expect to earn less than the personal allowance during the tax year (for example, if you are a student). If this applies to you, you can ask your tax office to 'split' your personal allowance between both jobs, so that you don't pay tax on either of them.

PAYE INCOME – THE FORM

Employees and directors who receive a tax return should also receive the supplementary pages E1 and E2 for employment to complete. If you have had more than one employment during the tax year, you must complete separate pages for each one.

You need to fill in the employment pages if you:

- work as an employee either full or part time and you earn a salary or wages, bonus, commission, tips or any taxable benefits
- received any lump sum payments
- work abroad but are liable for UK tax (if you're considered to be resident in the UK for tax purposes)
- receive directors' fees or money from other offices you've held.



Before you start to fill in the employment supplementary pages, make sure you have:

- your P60, which your employer must give you by 31 May 2002 (for the 2001-2002 tax year)
- your P45, if you left your employment during the tax year 2001-2002
- your coding notice for 2001-2002 and 2002-2003, if you have been sent one
- a list of all your taxable benefits. Your employer is obliged to give you a copy of form P11D by 6 July 2002 (or form P9D if you earn less than £8,500). This is the form that your employer sends to the Inland Revenue – it lists all your fringe benefits and their taxable values. Your P11D also gives a list of fixed expense allowances and expenses for which you've been reimbursed
- details of redundancy or any other payments you received when you left your job, which weren't part of your terms and conditions.

Details of employer

The first step is to enter your employer's PAYE reference (this will be on your P60), and its name and address. Enter the date you started or finished with this employer, but only if either was between 6 April 2001 and 5 April 2002.

You also have to identify whether you are a director of the company and if the company is a close one. A close company is one controlled by five or fewer participators (broadly shareholders, but they can be defined more widely) or by any number of participators who are also directors of the company.

INCOME FROM EMPLOYMENT

This part of the form tells the Revenue what income you earned during the tax year.

Money

Most of the income you receive will be your salary or wages. You should enter your payments for the year as they appear on your P60 (or P45 if you've left that employment). This should be your gross income less any payments you make to an employer's pension scheme or charity via a payroll deduction scheme. The figure shown on your P60 normally takes account of ▶

these. If it doesn't, deduct these amounts before entering a figure.

There are boxes on the form for payments you received that are not included on your P60 – tips, for example. You've also got to enter here any tax already deducted from the income payments. Your P60 or payslips will show this amount.

Benefits and expenses

Many people receive payments other than money; the ones listed in this section of the tax return are usually taxable.

Enter the taxable amount of the benefit in the relevant box. This amount might be called the 'cash equivalent' on your P11D. If you earn at a rate of less than £8,500 a year and are not a director, tax isn't due on certain benefits and expenses, so you may not have to complete all the boxes in this section.

You count as earning 'at a rate of £8,500' only if the pro-rata rate of your yearly earnings plus the value of any benefits and expenses payments are less than £8,500. So, if you earned £7,000 a year and had a perk (a car, say) with a taxable value of £2,000, you would be over the limit. If you earned £4,500 for six months' work, you would also be over the limit. See booklet 480 *Expenses and benefits. A tax guide* for more information.

The final box is for the total payments already made to you in respect of expenses. These are the total expenses you received – they may not all be allowable against tax. Include in this total any balancing charges added to your income. These might arise when you sell assets or equipment that you previously claimed capital allowances on, or stopped using for your work. For more details, see Revenue helpsheet IR206 *Capital allowances for employees and office holders*. However, don't include in the figure any expenses covered by an employer's dispensation. These are quite common, particularly with large employers. They mean the employer has come to an arrangement with the Revenue over certain regular types of expenses paid to their employees.

If an expense is covered by a dispensation, you don't have to claim it from the Revenue or declare you have received it. Only some expenses your employer pays may be covered by a dispensation – make sure you claim tax relief on any payments not covered.

MORE HELP

Inland Revenue leaflets

IR125 Using your own car or motorbike for work

IR136 Income tax and company vans – a guide for employees and employers

IR145 Low-interest loans provided by employers

IR161 Tax relief for employees' business travel

Inland Revenue helpsheets

IR204 Lump sums

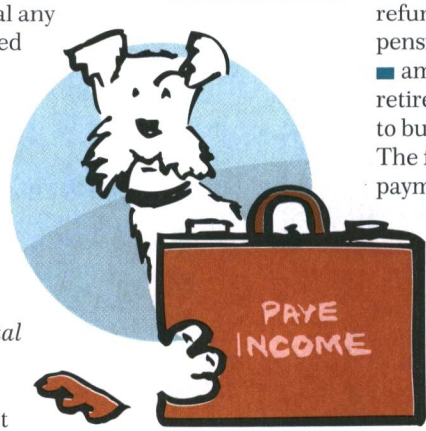
IR206 Capital allowances for employees and office holders

IR207 Non-taxable payments or benefits for employees

IR208 Payslips and coding notices

Inland Revenue booklet

480 Expenses and benefits. A tax guide



OTHER TYPES OF INCOME

The rest of the form covers lump sums, foreign earnings, and expenses incurred in doing your job.

Lump sums and compensation payments or benefits

Unless all you are entering is a redundancy payment, you'll need Inland Revenue helpsheet IR204 *Lump sums* to fill in this section, as different rules apply to different types of lump sum payments connected with your employment.

Broadly, the following payments are usually tax free, unless they are in the terms of your contract:

- any lump sum for an injury or disability which meant you couldn't carry on with your job
- compensation for loss of a job done substantially outside the UK
- gratuities received from the armed forces
- some lump sums or contribution refunds from an employer's pension
- amounts an employer pays into a retirement benefit scheme or uses to buy an annuity.

The first £30,000 of the following payments are usually tax free:

- payments that are solely for redundancy
- compensation if an employer breaks your contract (if it doesn't give the required notice, for example)
- payments that are not part of an employer's established practice and purely ex-gratia (so not in return for any work done, for instance). The Inland Revenue will want proof that the payment is really ex-gratia before it will agree to it being tax free.

Foreign earnings not taxable in the UK

If you are not 'ordinarily resident' in the UK, you may not be liable to UK tax on some or all of your earnings. Read the notes on employment (page EN6) to see whether this applies to you.

Foreign earnings deduction

This deduction applies only to people who perform their employment duties on a ship. If this applies to you, ask for helpsheet IR205 *Foreign earnings deductions for seafarers*.

Foreign tax for which tax credit relief not claimed

Enter in this box any foreign tax you have paid on your employment income but only if you do not want to claim tax credit relief. If you do want to claim it, leave this box blank and complete the foreign supplementary pages instead.

Student loans

Enter into the relevant box any student loan repayments deducted by your employer and included on your P60 or payslips.

If you have changed employers during the tax year, your P60 won't include student loan repayments deducted by your previous employer. So, if you had more than one employment in the year, you must use your payslips, in addition to the P60, to work out the figures that need to go in this particular box on each set of the employment pages you fill in.

If you don't have any previous payslips, try contacting your previous employer for this information. Failing that, contact your tax office and ask it to check whether it holds this information on its records.

Fringe benefits

You may not have to pay tax on all the perks your employer gives you. Here are the tax rules for the most common types of fringe benefit.

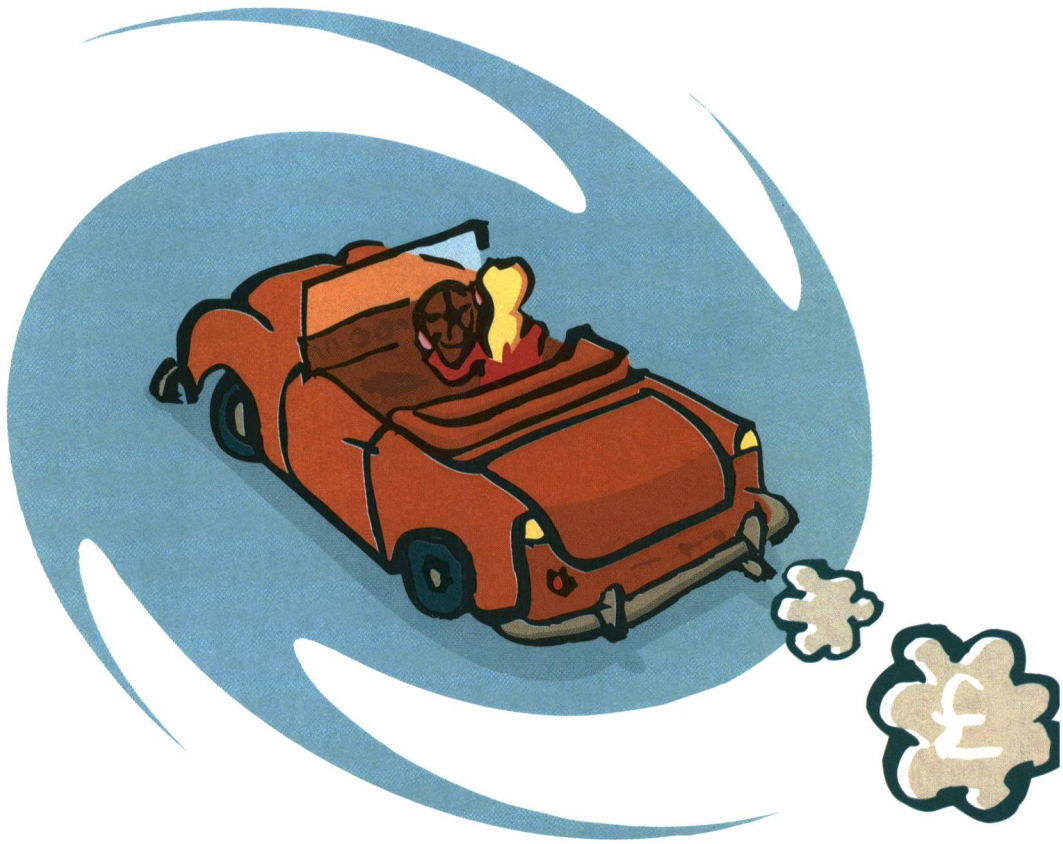
Your employer may give you fringe benefits – also known as benefits in kind, or perks. These are, broadly, non-cash items you receive on top of your salary.

The taxable value of most fringe benefits is the cost to your employer of providing them. But if your employer gives you something to keep, you generally pay tax on the item's market value. Anything you pay towards the cost of a perk is deducted when working out the taxable value. A key advantage of fringe benefits for employees is that you don't normally have to pay National Insurance on them – a saving of £100 on a benefit worth £1,000 at the standard NI rate.

TAX-FREE BENEFITS

You won't normally pay tax on:

- your employer's contributions to an approved or statutory pension scheme
- membership fees and subscriptions paid to approved professional bodies
- life and sick pay insurance (provided certain conditions are met), routine health checks and medical screening
- the first 15p of luncheon vouchers each working day
- shares or share options awarded to you under a plan approved by the Inland Revenue
- nurseries or play schemes provided in full or part by your employer (as long as it's wholly or partly responsible for financing or managing the nursery or play scheme). Childcare vouchers are taxable
- free or subsidised canteen meals provided for employees generally
- protective clothing necessary for your job, or a recognisable uniform you are required to wear
- small personal expenses, such as laundry or calls home, paid by your employer when you're away on business, provided they don't exceed £5 a night (£10 outside UK)
- specified removal and relocation expenses when you have to move to a new job or are transferred and need to change your main home, up to a maximum of £8,000 a move
- genuinely personal wedding or retirement gifts (note: a cash gift at retirement will attract tax at normal rates)
- long service awards such as gifts or shares. You must have worked at least 20 years with your employer, and the value must not exceed £20 per year of service. Cash awards will be taxed at normal rates
- gifts and goods from business contacts costing up to £150, provided that the gift is not in recognition of particular services and hasn't been procured by your own employer
- the value of any entertainment, such as a lunch, provided by someone other than your employer (or its associate companies)
- annual staff functions (such as Christmas parties) that are open to all staff and cost £75 a head or less a year
- prizes, totalling a maximum of £5,000, for ideas put forward through staff suggestion schemes
- books and fees paid for by your employer for some external training courses. Extra travel expenses and living costs that your employer pays may not be taxable either
- redundancy and welfare counselling services available to all employees generally
- retraining courses that an ex-employer pays for, provided this is available generally to all employees. Courses can last up to one year. The employee must have been employed full time for at least two years, must leave employment within two years after the end of the course and must not be re-employed within two years of leaving
- in-house sports facilities available to all employees ▶



- taxis home paid for by employers if you occasionally work until at least 9pm. Public transport must have stopped or it would be unreasonable to use it (for safety reasons, say)
- free parking at or near work
- travel and subsistence for disabled employees unable to use public transport (this also applies to all employees if public transport is disrupted)
- essential accommodation, travel and subsistence payments if you are temporarily absent from your permanent workplace for up to 24 months
- the cost of defending some legal claims against you as an employee (but not criminal fines such as parking fines), or the cost of any insurance that your employer pays to cover you against legal claims.

TAXABLE BENEFITS

Most of the following fringe benefits are only taxable if you earn over £8,500 (including the value of fringe benefits) or are a director. However, all employees, no matter how much they earn, pay tax on the provision of living accommodation and non-exempt vouchers.

Loans of money

If your employer lends you money, the taxable value is based on the difference between the interest you pay and the official rate of interest – 6.25 per cent for 2001-2002 up to 5 January 2002 and 5 per cent from 6 January 2002 for the remainder of 2001-2002 and for 2002-2003. The rate is subject to review in the event of any significant changes in mortgage rates.

There is no tax on cheap or interest-free loans of £5,000 or less. If the loan is for more than this, the interest on the whole amount is taxable. There's also no tax if your employer runs a lending business and lends money to you on the same terms as to the public. But any part of the loan your employer waives is taxed as income, and in certain cases could be taxed as a dividend.

Other common benefits

You pay tax on medical insurance premiums paid by your employer. For private use of a van, you pay tax on a flat amount of £500 a year (less if it is four years old or more, or if it is shared).

Low-rent accommodation

Low-rent and rent-free accommodation is taxable unless one of the following applies (although there are special rules if you are a director):

- you have to live in the home to do your job properly (as a caretaker, for instance)
- living in the home enables you to do your job better, and is customary in your kind of employment
- there is a special threat to your security, and you live in the home as part of special security arrangements.

If none of these applies, the taxable value is usually the greater of the gross rating value of the home or the rent your employer pays, less anything you pay. If there is no rating value, your employer must agree a value with the Inland Revenue. If your accommodation costs more than £75,000, you have to pay an additional charge.

RULES FOR LOW EARNERS

Low earners don't pay tax on most fringe benefits, including company cars and fuel. However, they are taxed on benefits that can be sold, or otherwise turned into money – but even then only on their second-hand value. See IR booklet 480 *Expenses and benefits – a tax guide* for full details.

All this applies only if you earn less than £8,500 a year – that is, if the pro-rata rate of your yearly earnings, plus the value of benefits and expense payments (whether or not they are taxable), is less than £8,500. So if you earned a salary of £7,000 a year and had a perk (a car, say) with a taxable value of £2,000, you would be over the limit. You would also be over the limit if you earned £4,500 (including perks and expenses) for six months' work.

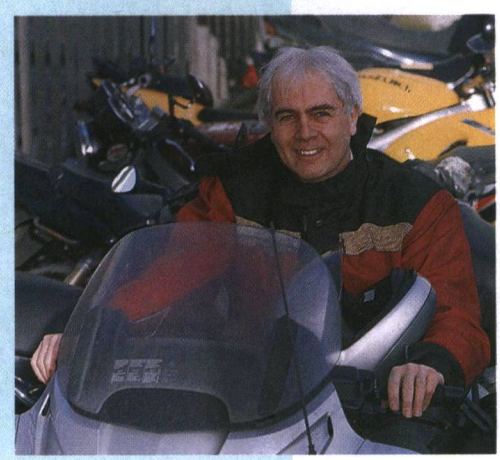
If you have two unconnected jobs with different employers, the £8,500 limit applies to each job. If you have more than one job with the same (or an associated) employer, these are treated as one job for deciding whether the £8,500 limit is reached.

MOTORCYCLISTS LOSE OUT IN TAX TERMS

Instead of providing him with a company car, engineer Colin Cherry's company provides him with a motorcycle to use when visiting building sites and test facilities. But he loses out in tax terms.

If Colin's employer gave him a company car, there would be no problem – he'd be taxed according to the rules on p26. If Colin bought a motorcycle to use for work, he could claim a fixed 24p for each business mile covered. However, the Inland Revenue views the motorcycle as a 'gift in kind' and does not recognise the idea of a 'company' motorcycle.

As Colin says: 'They tax me on a percentage of the bike cost, the full running cost and all the mileage for the bike, although it is used exclusively for work'. We think this is a glaring anomaly that penalises alternative forms of transport. If we can have company cars, then what's wrong with company motorcycles?



RULES FOR DIRECTORS

If you are a director of a company, you always pay tax on fringe benefits unless all of the following apply:

- you (together with close family members and certain other associates) own or control a total of 5 per cent or less of shares in the company
- you are a full-time working director, or work for a charity or non-profit-making company
- you are not also a director of an associated company
- you are below the £8,500 limit.

INCENTIVE SCHEMES

Below we explain the ways you can receive shares in your employer's company free of income tax and National Insurance contributions. The Inland Revenue's website www.inlandrevenue.gov.uk/shareschemes contains full guidance.

Share incentive plans

Since July 2000 employers have been able to offer this new incentive scheme (formerly known as Aesops). This plan is for all employees, but there may be a qualifying service period of up to 18 months. Some features are:

- companies can give up to £3,000 worth of free shares a year to each employee free of tax and NI
- some or all of these shares can be awarded to employees for reaching performance targets
- employees can buy up to £1,500 of shares known as partnership shares out of gross income (before tax and NI). For each share you buy, your employer has the option of giving you an extra one or two shares free.

Companies can also allow an employee to use up to £1,500 of dividends from these plan shares to buy further 'dividend shares'

MORE HELP

Inland Revenue booklet

IR480 Expenses and benefits – a tax guide

Inland Revenue leaflets

IR125 Using your own car or motorbike for work

IR134 Relocation packages

IR136 Company vans

IR172 Company cars

IR2002 Share incentive plans – a guide for employees

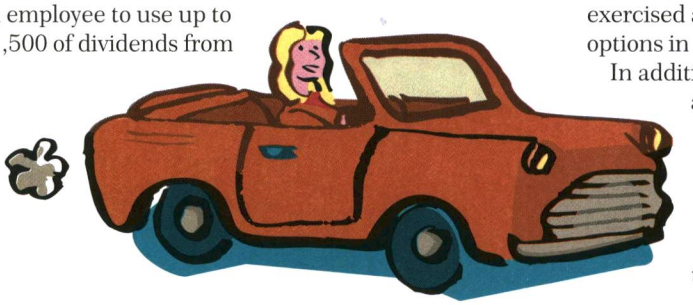
IR2006 Enterprise management incentives – a guide

Inland Revenue helpsheets

IR201 Vouchers, credit cards and tokens

IR202 Living accommodation

IR203 Car benefits and car fuel benefits



Approved profit sharing

Under approved profit-sharing (APS) schemes your employer can give you shares free of income tax, worth up to £3,000 a year (or 10 per cent of your earnings, if higher, up to £8,000 a year). Following the launch of share incentive plans (see left) in July 2000, APS schemes will lose their tax-free benefits by the 2002-2003 tax year. Tax-free awards of shares under APS schemes will be allowed only up to 31 December 2002.

SAYE share options

Under these schemes, your company gives you the right or option to buy its shares in the future at a price fixed now and up to 20 per cent below the current market price. You must buy the shares with the proceeds of a save-as-you-earn (SAYE) plan, which normally runs for three, five or seven years. You can pay in between £5 and £250 a month. All employees with at least five years service must be eligible. These schemes won't be affected by the share incentive plan.

Approved share options

Company share option plans give you an option to buy shares in your company in the future at a price fixed when the option is granted. Your option will not be taxed or subject to National Insurance when you exercise it to buy shares as long as the scheme is still approved when you exercise the option, you exercise it between three and ten years after you received it, and you haven't exercised any other similar options in the last three years.

In addition, if you got your option after 16 July 1995, the price you pay for the shares must not be below the market value at the time you were given the option, and the value of the shares under option must not exceed £30,000. These schemes also won't be affected by the share incentive plan.

Enterprise management incentives

Since July 2000, small trading companies and groups have been able to grant their employees enterprise management incentive (EMI) share options if both parties meet certain conditions. The company or group must not have gross assets exceeding £30 million (from 1 January 2002) when the EMI option is granted. Each employee can be granted EMI options over shares worth up to £100,000. The grant and the exercise of these options is normally free of tax and NI. CGT business taper relief runs from the date the option is granted rather than the date it is exercised.

USING YOUR OWN CAR FOR WORK

If you use your car for work, employers usually reimburse your expenses. Most pay a set amount for each business mile you drive to cover your petrol. Some also pay regular fixed sums for wear and tear. These payments are usually paid with no tax deducted, but are taxable over a certain limit.

From April 2002 a new flat-rate set of mileage rates has come into force, replacing the old Inland Revenue authorised mileage rates. For 2002-2003, the first 10,000 business miles for cars and vans can be paid tax free up to 40p per mile, and 25p per mile for any additional distance. Motorcycles and bicycles attract a flat-rate of 24p and 20p respectively for each business mile. These rates are the maximum that can be paid without having to pay tax and National Insurance contributions (NICs). If your employer pays you a higher allowance than this, then you pay tax and NICs on the excess. If your employer pays you less than the statutory amount, you can claim a refund on the difference. ▶

COMPANY CARS

You usually pay tax on a company car only if you earn £8,500 a year or more including benefits. The old system of company car taxation based on business mileage has been changed, but the taxable value of a car is still based on its list price, plus other charges.

The car's price

A car's price for tax purposes is usually its list price when first registered (or £80,000 if less) including: VAT and car tax if paid (but not annual road tax); delivery charges; the list price of any accessory fitted before you get the car (including VAT, delivery and fitting); and any accessories, such as alloy wheels, that cost more than £100 (including VAT and delivery) fitted after you get the car – the increased price applies from the beginning of the tax year in which the accessory was fitted. Where there is no list price (with classic cars, for example), you have to agree the price with the Revenue.

Anything that an employer pays to convert a company car for use by a disabled person is excluded, as is the cost of enabling a car to run on compressed natural gas or liquid petroleum gas, provided certain conditions are met. Anything you pay towards the purchase price of the car, or its accessories (up to £5,000), reduces the taxable price of the car by an equivalent amount.

Fuel charges

Any fuel your employer buys, but which is for your private use, is taxable unless you repay it all. But the taxable value is worked out on the size of the car, not on how much fuel is paid for (see the 'Fuel taxable values 2001-2002' table, right; the 2002-2003 figures were not available at the time of going to press). Multiply the figure for your car by your top rate of tax. You're not taxed on fuel that you use solely for business, but the journey that you make from home to your permanent workplace counts as private use.

BENEFIT CHARGES FOR CARS WITH AN APPROVED CO_2 EMISSIONS FIGURE

CO_2 emissions figure (g/km)			Percentage of car's price to be taxed (%)
2002-2003	2003-2004	2004-2005	
165	155	145	15[1]
170	160	150	16[1]
175	165	155	17[1]
180	170	160	18[1]
185	175	165	19[1]
190	180	170	20[1]
195	185	175	21[1]
200	190	180	22[1]
205	195	175	23[1]
210	200	190	24[1]
215	205	195	25[1]
220	210	200	26[1]
225	215	205	27[1]
230	220	210	28[1]
235	225	215	29[1]
240	230	220	30[1]
245	235	225	31[1]
250	240	230	32[1]
255	245	235	33[2]
260	250	240	34[3]
265	255	245	35[4]

1 Add 3 per cent if car runs solely on diesel
2 Add 2 per cent if car runs solely on diesel
3 Add 1 per cent if car runs solely on diesel
4 Maximum charge, so no diesel supplement

BENEFIT CHARGES FOR CARS WITH NO APPROVED CO_2 EMISSIONS FIGURE

Engine size (cc)	Percentage of car's price to be taxed	
	Car first registered before 1 Jan 1998	Car first registered on/after 1 Jan 1998
0-1,400	15%	15%[1]
1,401-2,000	22%	25%[1]
2,001+	32%	35%[1]
no cylinder capacity	32%	35%[2]

1 Add 3 per cent if car runs solely on diesel
2 Maximum charge, so no diesel supplement

HOW THE CO_2 RULES WORK

Bob has recently acquired a petrol-driven company car with an approved CO_2 emissions figure of 165g /km. If the price of the car for tax purposes is £10,000, then the taxable benefit from the car is:
165g/km = 15% x £10,000 = £1,500

As Bob is a basic-rate taxpayer, he has to pay:
£1,500 x 22% = £330

If on the other hand he'd got a petrol-driven car worth £25,000 with a CO_2 emissions figure of 240g/km, he'd pay:
240g/km = 30% x £25,000 = £7,500
£7,500 x 22% = £1,650

Change in tax rules

From April 2002, the way tax is assessed on company cars has changed. The tax will still be based on a percentage of the car's list price, but the amount of business miles driven is now irrelevant. Instead, tax is assessed on the level of the car's carbon dioxide (CO_2) emissions.

Cars with the lowest emissions – 165 grams per kilometre (g/km) or less in 2002-2003 – attract the lowest tax charge of 15 per cent. There is a 1 per cent rise in tax for every 5g/km rise in emissions of carbon dioxide, up to a top rate of 35 per cent tax for cars with emissions of 265g/km. These parameters will be reduced by 10g/km in both 2003-2004 and 2004-2005 (the 35 per cent tax rate will start at 255g/km and then 245g/km in those years).

For this system to work, you have to know the right CO_2 emissions figure for your particular car. For cars first registered in the UK from 1 March 2001, the CO_2 emissions figure is shown on the Vehicle Registration Document. The charge over the next three years for cars with an approved CO_2 emissions figure is given in the top table, left.

Cars without an approved CO_2 emissions figure will be taxed according to their engine size (for details , see the bottom table, left). There will also be a supplement of 3 per cent on the tax for diesel cars unless they meet the European Community's Euro IV standard for cleaner cars.

For information on the tax rules that applied to company cars in the 2001-2002 tax year, see 'Fringe benefits', p10, *Tax Saving Guide 2001*.

FUEL TAXABLE VALUES 2001-2002

Engine size	Petrol (£)	Diesel (£)
up to 1400cc	1,930	2,460
1401 to 2000cc	2,460	2,460
over 2000cc	3,600	3,600

Tax credits

The working families tax credit (WFTC) and disabled person's tax credit (DPTC) are designed to help families and disabled people on lower incomes.

These tax credits are administered by the Inland Revenue instead of through the social security system.

WORKING FAMILIES

WFTC is available to couples (married or unmarried) or single parents who have one or more children under 16 (or under 19 if in full-time education) living with them. To be eligible, you (or your partner) must also work 16 hours a week or more and be resident in the UK and entitled to work here. From April 2002, it will comprise:

- a basic tax credit of £60 a week
- an extra £11.65 if one partner works at least 30 hours a week
- a tax credit for each child: £26.45 from birth, £27.20 from the September after their 16th birthday until the day before they are 19
- a childcare tax credit of up to 70 per cent of eligible childcare costs to a maximum of £135 a week for one child, or £200 a week for two or more children (April 2001 rates – may change in April Budget)
- an extra £35.50 a week for a child with a disability
- an enhanced disability payment (see right).

However, WFTC is reduced by 55p for each £1 of net income above £94.50 – net income is your earnings less tax, National Insurance, and half of any pension contributions.

MORE HELP

Inland Revenue booklets

WFTC/BK1 Your guide to working families tax credit

DPTC/BK1 Your guide to disabled person's tax credit

Inland Revenue helplines

Working families tax credit: 0845 6095000

Disabled person's tax credit: 0845 6055858

Northern Ireland: 0845 6097000

HOW WORKING FAMILIES TAX CREDIT WORKS

Jo is a lone parent who earns £200 a week (after tax and National Insurance) and works less than 30 hours a week. Childcare for her son, Ben, age six, costs £60 a week. She has no savings.

Basic tax credit	£60
Under-16 tax credit for one child	£26.45
Childcare tax credit (70 per cent of £60)	£42
Total tax credits	£128.45
Less 55% of £105.50 (income above £94.50)	£58.03
Total WFTC	£70.42
Total income	**£270.42**

DISABLED PERSON'S

DPTC works in a similar way to WFTC. You don't have to be looking after children to receive it, but you get more if you do. You can qualify if an illness or disability puts you at a disadvantage in getting a job and you work at least 16 hours a week. You also need to be in receipt of a qualifying incapacity or disability benefit, resident in the UK and entitled to work here. From April 2002 DPTC is made up of:

- a basic weekly credit of £62.10 for single people or £92.80 for a couple or lone parent
- an extra £11.65 if you work at least 30 hours a week
- a tax credit for each child in the family, at the same rates as WFTC
- an extra £35.50 for each child you have who receives disability living allowance or is registered blind (or has been registered in the last 28 weeks)
- a childcare credit worth the same as the WFTC childcare element
- an enhanced disability payment.

DPTC is reduced by 55p for each £1 of net income above £73.50 for a single person. For a couple or lone parent, DPTC is reduced by 55p for each £1 of income over £94.50.

Enhanced disability payment

A new tax credit was introduced from April 2001 for people claiming either WFTC or DPTC who are receiving higher-rate disability living allowance for care. From April 2002 the payment is £11.25 a week for a single person (so paid only with DPTC), £16.25 a week if paid to a lone parent or couple, or £46.75 a week if paid on behalf of a child. The child's payment is paid instead of the disabled child tax credit.

YOUR SAVINGS

You are eligible for tax credits only if your savings are £8,000 (WFTC) or £16,000 (DPTC) or less. But savings above £3,000 are taken into account in assessing your income. It is assumed you earn £1 a week from each £250 of savings above £3,000. So someone with £5,000 is assessed as having £8 a week income (£5,000 – £3,000) ÷ £250.

RECEIVING CREDITS

Application forms are available from benefit agency offices, Jobcentres, post offices, citizens' advice bureaux, tax enquiry centres or the tax credit office.

Employees receive tax credits through the PAYE system (as a reduction in tax owed or as an extra payment). The Revenue pays tax credits for the self-employed direct to their bank accounts.

Couples can choose which partner receives WFTC (it can't be split between them). You can't transfer DPTC (even the childcare element) to anyone.

Self-employment

If you're self-employed, you enjoy more favourable tax treatment than employees. Use this chapter to ensure you make use of the advantages of working for yourself.

If you work for yourself as a sole trader and are considered self-employed for tax purposes (taxed under schedule D), you have greater scope than employees to deduct expenses from your income. You will also pay lower National Insurance contributions, although this reduces your rights to some state benefits.

In this section we explain how to work out your tax, business expenses and allowances if you're self-employed. However, if your business is run as a limited company, the rules are different from those set out here. For more information on limited companies, contact your tax office.

TAXES YOU MAY PAY

If you work for yourself, you may have to pay some or all of the following.

Income tax

If your profits from self-employment plus other income come to more than your tax-allowable outgoings and allowances, you'll have to pay income tax. If you're a partner in the business, you are treated as if you are a sole trader with business profits equal to your share of the partnership profits.

Self-employed people normally pay their tax in the January of the relevant tax year and the July following the end of that tax year. There may be a final payment in the January after that – see 'Payments on account', p37, for more details.

National Insurance

This is dealt with in the chapter on National Insurance (NI) – see p39.

Value added tax

You must register for value added tax (VAT) if, at the end of any month, the taxable turnover of all your business activities in the year ending on the last day of that month exceeds a certain limit set by Customs and Excise. You must also register if you think your turnover will exceed the limit during the next 30 days. At or below this limit, you can choose whether to register for VAT. In the tax year 2001-2002, the limit was £54,000. The 2002-2003 level had not been published at the time we went to press.

If you're not registered, you can't reclaim VAT on things you buy for business, but you use prices including VAT when recording expenses and allowances.

The March 2001 Budget proposed a new optional flat rate scheme for businesses with a taxable turnover under £100,000. The new scheme would mean these businesses can avoid having to account internally for VAT on all of their purchases and sales. Instead VAT would be calculated as a percentage of their taxable turnover. The percentage will depend on the type of business. Full details will not be announced until the 2002 Budget.

Business rates

If you have business premises, such as a shop or office, you must pay the uniform business rate. This also applies if part of your home is used exclusively for business. If the part of your home used for business is also used for domestic purposes, business rates shouldn't be levied, and you may be able to claim part of your council tax as an allowable business expense.

DO YOU COUNT AS SELF-EMPLOYED?

For your work to count as self-employment, you must convince your tax office that you genuinely work for yourself and not, in reality, for an employer. Essentially, one main question needs to be answered: 'Are you in business on your own account?'.

If you answer 'yes' to the following questions, it's highly likely you will be treated as self-employed:

- Do you have the final say about how your business is run? For example, do you decide where you work and the hours that you work?
- Do you put your own money at risk?
- Do you bear any losses of the business, as well as keep the profits?
- Do you provide the main items of equipment, such as fax machines and computers, that you need to do your job?
- Are you free to hire people on terms you choose to do work that you have taken on? Do you pay them out of your own pocket?
- Do you have to correct any unsatisfactory work in your own time, and at your own expense?

Even if you answered 'no' to some, or most, of the questions, you may still be self-employed. Get a copy of Inland Revenue leaflet IR56, which will tell you more. If you are still unsure, arrange an appointment with your own tax office or a local Revenue enquiry office. They can give you a written decision about your employment status.

SPOUSES CAN SAVE TAX

If your spouse helps with the business and pays tax at a lower rate than you, a simple way to reduce your profits is to pay them a wage. As long as this is a reasonable amount, it counts as a tax-allowable expense and can be deducted from profits. But if their salary reaches £89 a week (in 2002-2003), they have to pay National Insurance, and you will be liable for employer's National Insurance.

TAXABLE PROFITS

Broadly, you pay tax on your yearly takings less allowable business expenses, provided they are incurred wholly and exclusively for the purpose of the business.

The main expenses you can claim are explained in 'What you can claim', p31. Strictly speaking, any payment partly for business and partly for personal reasons is not allowable. But, in practice, the Revenue lets you claim a proportion of some joint expenses, such as the cost of running a car used partly for business, and some domestic bills if you work from home.

There may also be adjustments to make before you can arrive at your taxable profit, such as allowances for buying capital equipment. These are explained in the following sections.

Stock values

You can deduct from profits the cost of raw materials or goods bought for resale, but only if they are actually sold during the accounting year. Their value is generally the lower of their cost to you or their market value. If stock is unsold at the end of the year, you can carry forward the cost and deduct it when you sell the stock.

Money owed

Accounts have to be kept on an accruals basis. This means you must include income in your accounts when you sell goods or do work, and include expenses when they are due, regardless of whether you have received or made any payment.

Capital allowances

When you buy capital equipment (items that aren't for resale and that are of lasting use to the business, such as cars), you do not deduct their cost from profits at the time you buy them. However, you can still receive tax relief on these sorts of things by claiming capital allowances.

These allowances are worked out as follows. The cost of each capital item is added to a pool of expenditure. When you calculate your taxable profits, you can usually deduct up to 25 per cent from the pool as a writing-down allowance. However, small or medium-sized businesses can claim a first year allowance of 40 per cent on certain items in the year of purchase. Also, 100 per cent of the cost of information technology purchases are allowable against profits for purchases in the three tax years beginning April 2000.

If you sell a capital item, the sale proceeds are deducted from the pool before the writing-down allowance is worked out. If the proceeds of all the items you sell come to more than the value of the pool, the excess (which is known as a balancing charge) is added to your profits for the year and taxed.

If you sell an item for less than its written-down value, you can't normally claim tax relief on the whole of the difference between the cost and sale prices until the business ceases.

You can claim tax relief earlier if you have elected to have the item treated as a short-life asset. These are items with an expected life of less than five years. You can claim tax relief when you dispose of them. These must be put in other separate pools to capital items. You also need to keep separate pools for assets used both privately and for business – the allowance you get is in proportion to your business use. The rules for cars are slightly different. Cars are not normally added to the pool. Instead the 25 per cent allowance is calculated separately and is capped at £3,000 a year in the 2001-2002 tax year.

Using your losses

You can use losses to reduce your overall tax liability now or in the future. They can even be used to reduce tax due on income or profits you received in previous years.

A loss incurred in an accounting year can be:

- carried forward indefinitely to set against profits from the same business in future years
- set against any other type of income in the current tax year. If this does not use up the whole ▶

loss, you can set the remainder against any capital gains for the year if you wish

- set against any other type of income for the previous tax year, provided the business was carried on in that year. If this does not use up the whole loss, you can set the remainder against any capital gains for the previous year
- set against other income (but not capital gains) from the previous three tax years if the loss is incurred in the first four tax years of your business
- set against profits from the business over the previous three years if the loss is incurred in the last 12 months before closing down.

Pre-trading expenses

If you incur expenses before you start trading, you may still be able to claim these as pre-trading costs. Any expenses that would be allowable if incurred after the business had started could be treated as pre-trading expenses.

BECOMING SELF-EMPLOYED?

Here are some things you should do if you are becoming self-employed:

- ☑ get a copy of the Inland Revenue's free pack *Starting up in business*. It tells you everything you need to know about tax (including VAT) and National Insurance
- ☑ register with the Inland Revenue within three months from the last day of the month in which you started your self-employment. If you don't, you risk a fine of £100. You can register by using form CWF1, which is included in the Revenue's pack or available from any tax office. You can also register by ringing the Inland Revenue helpline for the newly self-employed on 08459 154515
- ☑ keep a list of fixed assets such as cars and office equipment
- ☑ keep cash books recording cash paid to and taken out of the bank, and any petty cash dealings
- ☑ set up an accounting system detailing sales and purchases, and sort purchases into types (stationery, travel, and so on)
- ☑ keep records of stocks of raw materials and any other goods bought, used or sold
- ☑ include items in your accounts that you already own but may use for business, such as a computer. You can claim capital allowances and may be able to recover VAT
- ☑ get written receipts and file them in date order. Record items without receipts in a notebook
- ☑ save money to cover your tax bills in January and July
- ☑ record business mileage, petrol, and all running costs if your car is used solely or partly for business
- ☑ choose your accounting year-end
- ☑ count any expenditure before you start your business as pre-trading expenses
- ☑ set first-year losses against other income
- ☑ check that you have adequate pension arrangements and life insurance. Consider taking out permanent health insurance in case you're ill.

STARTING UP AND CLOSING DOWN

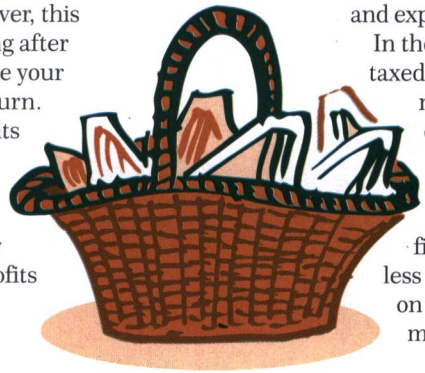
Special rules apply in the first and last years of your business if you are self-employed – the main ones are explained here.

Starting up

When you start in business, you choose an accounting period – the 12-month period over which your tax will be worked out. You can choose any date as the end of your accounting period.

If you want to keep things simple, run your accounting year the same as the tax year (called fiscal accounting). However, this means you don't have long after your year-end to complete your accounts and do your return.

If you expect your profits to rise steadily, consider a year-end early in the tax year (30 April, say). This maximises the delay between earning your profits and paying tax, which is good for cash flow. The downside is that a year-end early in the tax year means carrying forward higher overlap profits (see right).



In the first year, you're taxed on your actual profits from the date your business started up until the end of the tax year in April. This is worked out on a proportion of the profits in your first accounting period. If, for example, you started up on 1 January 2002 and your first accounting period ends on 31 December 2002, your tax bill for 2001-2002 is based on the assumed profit in the period from 1 January to 5 April 2002. So if your profit for the 2002 accounting period is £10,000, your 2001-2002 taxable profit will be 95/365 (days) x £10,000 = £2,603. With a 31 December date, these accounts will probably not be available when you do your tax return. You will be expected to estimate the income and expenses for the taxable period.

In the second tax year, you are taxed on the profits for the 12 months up to the accounting date in that year, as long as you've been in business for at least a year.

If you're preparing your first accounts and they cover less than a year, you are taxed on your profits for the first 12 months of trading. If there is no accounting date in the second tax year, you are taxed on your profits for the tax year itself. In the third and subsequent years, businesses are taxed on the normal current-year basis – tax is based on profits for the accounting year ending during the current tax year.

Overlap profits

Because of the way profits are taxed when you first set up in business, under the opening-year rules some profits may be taxed more than once. They are called overlap profits and you get overlap relief against this excess taxation – but not until you close your business, or sooner if you change your accounting date to one falling later in the tax year.

You have no overlap profit and avoid the complications of opening-year rules if you choose fiscal accounting. This means having an accounting year which coincides with the tax year; an end-March accounting date also qualifies.

The drawbacks are that, if your profits increase, you pay tax on them earlier, and you also have less time in which to draw up your accounts than if you choose an accounting date that's earlier in the tax year.

Keep accurate records

If your business is straightforward, you may be able to handle your tax affairs yourself. However, even if you use an accountant, you're still responsible for your own tax.

It is a legal requirement for all taxpayers to keep adequate records to back up the information provided on their tax return (although you don't need to send them in with it). These records must be kept for five years from 31 January following the relevant tax year – see Revenue booklet SA/BK3.

Closing down

You are taxed in the year you close down on your profits from the accounting date on which the tax for the previous year was based, up to the date of closure, less any overlap profit brought forward.

For example, if you have a 30 April accounting date, your 2001-2002 tax will have been based on your profit for the year to 30 April 2001. If you cease trading on 31 March 2003, you'll be taxed in 2002-2003 on the profits for the 23 months to 31 March 2003, but will have 11 months' overlap relief to set against these.

Check out the accounting date

Here's why the accounting date you choose is crucial. Imagine you've been in business for several years and your accounting year ends on 5 April. You would record taxable profits for the year to 5 April 2002 on your 2001-2002 tax return. You pay tax on this income in January and July 2002 and January 2003.

If your accounting year ends on 30 April, you enter profits for the year to 30 April 2002 on your 2002-2003 return (as your accounting year ends in that tax year). You would pay tax in January and July 2003 and January 2004.

This gives an extra year to pay tax and prepare records, even though the period covered is largely the same (but see 'Overlap profits', p30). ▶

WHAT YOU CAN CLAIM

Here we set out the main expenses that self-employed people can claim for, and those that they can't. An expense allowable for one business may not be for another. If in doubt, claim. ☑ means normally allowed ☒ means normally not allowed

☑ **The cost of goods for resale and the cost of raw materials; discounts on sales; payments to subcontractors and the cost of materials supplied in the construction industry; fuel costs if your primary business is road transport (but not any private fuel); the cost of small tools.**

☑ **Recruitment agency fees; wages, salaries and redundancy payments to employees; insurance costs and pension benefits for employees and their dependants; training costs; the cost of temporary secondment of your employees to certain charitable and educational organisations; some types of childcare provision for the children of your employees; employer's National Insurance contributions for employees; the cost of hiring locums or subcontractors; insurance premiums to cover providing locums in the event of your being ill; keyman insurance cover for employees (although the benefits from the policy may be taxed); staff entertainment such as the Christmas party (up to certain limits).**

☒ Your own wages, salary or drawings from the business, wages paid to family members if these are excessive for the work done; the cost of premises and equipment for a workplace crèche (although this may qualify for capital allowances); your own National Insurance contributions and income tax; your own pension costs (although you can get personal tax relief on these); your own life, keyman, accident, permanent health and private medical insurance.

☑ **Heating; lighting; cleaning; water rates; rent for business premises; business rates. If you work from home: a proportion of the lighting, heating, cleaning and insurance costs; a proportion of rent (and domestic rates in Northern Ireland) or of mortgage interest if part of your home is used exclusively for business (although there may then be a capital gains tax bill when you sell your home); possibly a proportion of council tax, if you use part of your home exclusively for business.**

☒ The initial cost of buildings (but part may qualify for a capital allowance); council tax relating to the private use of your main home; a proportion of other bills relating to your private use of the home.

☑ **General maintenance of business premises (a proportion if you work from home); repairs to business equipment.**

☒ Alterations and improvements to business premises (these may qualify for capital allowances); any proportion relating to private use.

☑ **Telephone bills (but not the rental charge and only a proportion of the call charges if you also use the phone for private calls); postage; stationery; delivery costs; printing; software with a limited lifetime; books and magazines used only for business purposes.**

☒ Most payments you make to clubs, charities, etc; money paid as result of extortion.

☑ **The running costs of your own car, such as insurance, servicing, repairs, road tax and petrol (a proportion only if it is also used privately); the cost of hiring cars or vans; parking costs. But leasing charges are only fully deductible on cars costing up to £12,000 (in the 2001-2002 tax year).**

☒ Travel between your home and your workplace; the cost of buying a vehicle (although this may qualify for capital allowances); parking and motoring fines.

☑ **Travel and accommodation on business trips and travel between different places of work; the cost of travel from the UK (and back again) to carry out business that is performed outside the UK, provided that the trips are exclusively for business reasons.**

☒ Meals, except a reasonable amount for breakfast and evening meals on overnight trips.

☑ **Newspaper and magazine advertisements, mailshots and other forms of promotion; free samples; gifts up to £50 a year (from 6 April 2001) to any one person, provided that they advertise your business and the gifts are not food, drink, tobacco or vouchers for goods.**

☒ Any business entertainment such as lunches with clients; most gifts.

☑ **Accountants' fees; some solicitors' fees; some costs of architects and surveyors; the cost of professional indemnity insurance.**

☒ Legal fees and fines if you break the law; the cost of settling tax disputes.

☑ **Money owed to you which is unlikely to be paid.**

☒ General reserves for bad debts.

☑ **Interest on, and cost of arranging, business overdrafts and loans.**

☒ Your capital repayments; interest on overdue tax.

☑ **Bank charges, credit card charges, and the interest element of hire purchase charges (the amount you pay less the cash price); leasing costs (but these are restricted on cars costing over £12,000 in the 2001-2002 tax year).**

☒ Capital repayments; the capital element of hire purchase charges.

☑ **Special clothing that is suitable only for work; fees paid to register trade marks and designs.**

☒ The cost of clothes which could be worn for non-work purposes; the cost of buying a patent (although this qualifies for a capital allowance).

SELF-EMPLOYMENT– THE FORM

You will have to complete supplementary pages SE1 to SE4 for self-employment if you worked for yourself in a trade, profession or vocation in the UK or abroad during the 2001-2002 tax year. This section takes you through these pages.

Before you start filling in the form, collect together:

- your business accounts covering your 'basis period' (see below) for the 2001-2002 tax year
- your books and records if you do not have accounts
- details of all goods bought and sold
- all receipts and expenses.

Keep records of business transactions relating to the 2001-2002 tax year until at least 31 January 2008.

Read through the form and the Inland Revenue notes on self-employment before starting, and order any helpsheets you think you might need from the Inland Revenue orderline (0845 9000 404). There's a useful glossary of terms in the Inland Revenue notes on self-employment on page SEN11. Forms and most helpsheets can also be downloaded from the Inland Revenue website (www.inlandrevenue.gov.uk).

Business details

The first part of the form asks you for general details. You should enter here the name, description and address of your business, along with the start and end date of your accounting period. Each tax year, you pay tax according to the profit for the 'basis' period that ends in the tax year. So, in the first year, you're taxed on your profits from when you start up to the end of the tax year in April. As we said earlier in this chapter, after the first two or three years, your basis period becomes the same as your accounting period. See 'Starting up', p30, for more details. If your accounting date changes, you must also tell the Inland Revenue – see helpsheet IR222 for more information.

You must state whether the name or address of the business has changed since your last tax return and also give the date your business started if after 5 April 1999, or the date it closed if before 6 April 2002. There's a box to tick if you are a foster carer or adult carer, or you carry out your business wholly overseas. If this applies, you may only need to complete a limited number of boxes. See the Inland Revenue's notes on self-employment, page SEN10, for more details.

Capital allowances

There is a summary of what you can and can't claim as capital allowances, and what you should declare as balancing charges, on page SEN4 of the Inland Revenue notes for self-employment. We've also given details of capital allowances in the earlier part of this chapter – see p29.

Turnover below £15,000

If your annual turnover (all the money earned by your business before deducting expenses) is below £15,000 for a full year, then you can fill in the special shortened section about your income and expenses. You simply enter your turnover and other taxable business receipts and subtract your allowable business expenses to get your net profit (or loss) for the year. You should include the normal selling price of all goods taken out of the business (less anything you paid for them) for your personal use or for your family or friends as income.

Turnover £15,000 or more

If your annual turnover was £15,000 or more, you must fill in the relevant section. If you are VAT registered, you can choose to enter your business income and expenses net or inclusive of VAT. For more information on VAT, see the Revenue's notes on self-employment, page SEN4.

Disallowable expenses

The self-assessment form has two columns for detailing expenses. The column on the right is for listing all of your business expenses. However, some of the expenses listed in these boxes may not be allowable for tax purposes. These are called 'disallowable expenses' and are listed in the column on the left. See the list on page SEN7 of the Revenue's notes for disallowable expenses.

Tax adjustments to net profit or loss

Your tax return contains a section that deals with any amounts you must either add or subtract from your net profit or loss – tax adjustments. These adjustments happen for many reasons. One reason is disallowable expenses (see above). Another is to cater for goods taken out of the business for personal use or by friends or family. Adjustments known as balancing charges can arise when you sell an item, give it away, or stop using it for the business. These balancing charges are added to your taxable profits. You can also claim tax allowances (called capital allowances), which are deducted from your taxable profits.

Adjustments to arrive at taxable profit or loss

First, you need to enter the date on which your basis period for the 2001-2002 tax year starts and ends. Then you copy your profit or loss figure (whichever applies to you) into the next box. If you don't need to give details from any of your accounts this year (see earlier), enter '0' into this box and include the appropriate amount of any profit returned last year in your

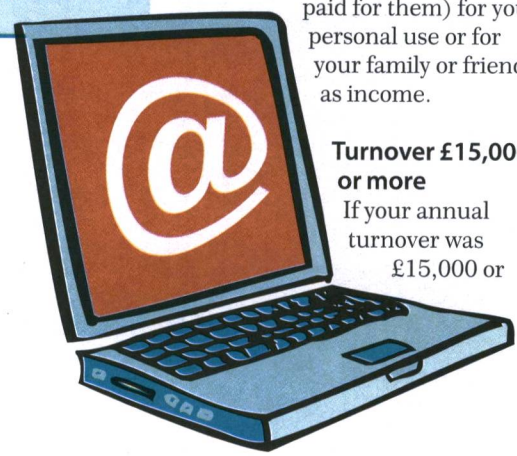
MORE HELP

Inland Revenue leaflets

CWL2 National Insurance for the self-employed
IR56 Employed or self-employed?
IR72 Inland Revenue investigations
IR73 How investigation settlements are negotiated
P/SE/1 Starting your own business?
SA/BK3 Self-assessment – a guide to keeping records for the self-employed

Inland Revenue helpsheets

IR220 More than one business
IR222 How to calculate your taxable profits
IR224 Farmers/ market gardeners
IR227 Losses
IR229 Information from your accounts



entry for the next box. If your basis period is not the same as the period covered by your accounts, you may need an adjustment to the profit or loss figure. Refer to Inland Revenue helpsheet IR222, which explains how to calculate this adjustment. If the adjustment means you have to deduct a figure in the next box, enter the figure in brackets and remember to subtract it when you are calculating your total taxable profits.

An important part of this section is the boxes that deal with overlap profit and relief. As explained earlier, because of the way profits are taxed when you first set up your business, profits can be taxed more than once. You only get overlap relief against this extra tax when you actually close your business or change your accounting date in such a way that your basis period exceeds 12 months. As a result, you might be able to claim overlap relief if you closed or sold your business during 2001-2002.

Losses

If you have made an overall loss, you may be able to use it to cut this year's tax bill, or you could even use losses from previous years. Inland Revenue helpsheet IR227 gives more details on dealing with losses, as does the earlier part of this chapter.

If you wish to offset your 2001-2002 loss against other income you received in 2001-2002, you should enter the amount you are claiming in the appropriate box.

You can save tax by offsetting the loss in this tax year against an earlier year's income. If you want to do this, enter the loss you wish to claim in this box. If you have already claimed it, still include it here and provide details in the 'Additional information' section on the last page of the self-employment pages, SE4.

There is a box for any losses you made in 2001-2002 that you wish to carry forward to use against future profits. There's another box for losses that you've carried forward in this business in years before 2001-2002 that you have brought forward but not yet used. You can use this loss against your net profit for 2001-2002.

Class 4 National Insurance contributions

For the 2001-2002 tax year, self-employed people pay Class 4 National Insurance contributions on taxable profits between £4,535 and £29,900. The rate paid is 7 per cent. However, you may not have to pay if you are:

- a man aged 65 or over or a woman aged 60 or over at 6 April 2001 (this includes a person whose birthday fell on 6 April 2001)
- aged under 16 on 6 April 2001 and if the Inland Revenue National Insurance Contributions Office has granted you 'exception'. (To apply for exception, complete form CA2835U, which is available from the Inland Revenue National Insurance Contributions Office)
- not resident in the UK for tax purposes during 2001-2002
- a trustee, or a diver or diving supervisor.

If you have income from employment, and pay employee's National Insurance contributions (Class 1), you may not have to pay Class 4 National Insurance as well. Your Class 4 contributions might be deferred until your overall contributions can be determined. However, only the National Insurance Contributions Office can agree to deferment – ask for leaflet CA72, available from the Contributions Office, which has more details.

You must tick the appropriate box if an exception or deferment applies and enter '0' in the relevant boxes. You must explain in the 'Additional information' box why you are claiming either an exception or deferment. In the next box you have to enter any adjustments to your net profit for National Insurance purposes. There's a working sheet on page SEN10 of the Revenue's notes on self-employment that explains whether any adjustment applies to your business.

In the final NI box, you must enter the amount of Class 4 National Insurance that is due on the profit you made in 2001-2002. Use the working sheet on page SEN10 to work it out.

Construction industry subcontractors

If you are a subcontractor in the building industry, you may have received payments under the Construction Industry Scheme. If so, enter in this box the total deductions made on account of tax from payments made to you during the period 6 April 2001 to 5 April 2002. The Revenue's notes on self-employment, page SEN10, give more information, and the Inland Revenue provides various leaflets for subcontractors in the construction industry.

Summary of balance sheet

If you don't have accounts or a balance sheet, or your turnover was less than £15,000, leave this section blank. But for everyone else, you've got to provide a summary of your balance sheet. If you do complete this section, read page SEN10 of the Inland Revenue's notes on self-employment. If you have accounts and they include a balance sheet, you can simply copy the entries from your accounts to this section of the return.

Make sure you transfer all figures to the summary and include each one only once. Don't include figures that do not appear in your balance sheet.

Small business help

- **England** 08456 009 006 www.businessadviceonline.org
- **Wales** 08457 969798 www.businessconnect.org.uk
- **Scotland** 08456 096611 www.sbgateway.com
- **Northern Ireland** 028 9049 1031 www.ledu.com

Income from property

More and more people are becoming landlords. This chapter explains what your tax liabilities are if you receive income from land or property.

Some people let out their home because they've gone to live abroad, others let out property they've inherited. Some let rooms in their house to help pay the mortgage, and a growing number of people buy property to let as an investment.

Income from property includes rents, chargeable premiums on leases, and ground rents (feu duties in Scotland).

Although income from land and property is technically classed as investment income, it's treated for tax purposes much like income from a business. However, there are some important differences, which we've covered opposite.

HOW RENTAL INCOME IS TAXED

Rental income you receive isn't taxed like other investment income from shares, National Savings or deposit accounts. Instead, it's added to your other taxable income (from employment, self-employment and so on), and taxed at your top rate of tax (10, 22 or 40 per cent). If your rental income falls into the basic-rate tax band, it doesn't qualify for the special rate given to savings or capital gains of 20 per cent. Instead, it attracts the normal basic rate tax of 22 per cent.

You must complete the land and property supplementary pages of the tax return for most types of rental income you receive. However, income from overseas property is declared using the foreign income pages, and income from a guest house, hotel or bed and breakfast is normally declared using the self-employment pages. Ask your tax office if you are unsure which section to fill in.

BUSINESS INCOME VS RENTAL INCOME

Even if you own only one property and don't think of it as a 'business', there are many similarities in the way rental income and business income is treated. However, the differences, although subtle, are important, so you should be aware of how the Revenue classifies the income you receive. If you are in any doubt, ask your tax office.

For the 2002-2003 tax year, you pay tax on rental income earned from the tenants' use of the property between 6 April 2002 and 5 April 2003. (You must declare rental income for the tax year it's due, even if you're not paid until the tax year is over.) If your income is from a business, however, you pay tax on the income earned in your accounting year. Your business accounting year may have a different start and end date from the tax year (see 'Starting up', p30). The other main differences are:

- business income losses can be offset against other income or capital gains, whereas most rental income losses can be offset only against other rental income
- capital gains tax rollover and retirement relief and inheritance tax business property relief are sometimes available on business income
- what you can claim as capital allowances will differ depending on whether your income is taxed as true business income or rental income.

TYPES OF RENTAL INCOME

Broadly, there are four categories that rental income might fall into. You must find out (with the help of your tax inspector if necessary) how your income is treated so that you know what reliefs and allowances you can claim.

Rent-a-room scheme

Owner-occupiers or tenants who let part of their only or main home as furnished accommodation may be able to qualify for rent-a-room relief. This means they pay no tax at all on gross rents (that is, before expenses) up to £4,250 in the 2001-2002 tax year. To qualify for rent-a-room relief, you must live in the property at the same time as the tenant for at least part of the tax year. You can still then claim the relief for that year even if you've left the property. If two or more people receive rental income, the exemption limit is £2,125 for each person. So, for example, three joint owners could get £2,125 each, that's £6,375 between them.

Any charge you make for meals, cleaning, laundry and so on must be added to the rent received when you calculate your gross rents, and you can't deduct expenses.

To claim rent-a-room relief, answer 'yes' to the relevant question on the tax return page relating to land and property. If you don't normally complete a tax return, you don't need to tell your tax office you receive rental income as long as it's all covered by the rent-a-room scheme.

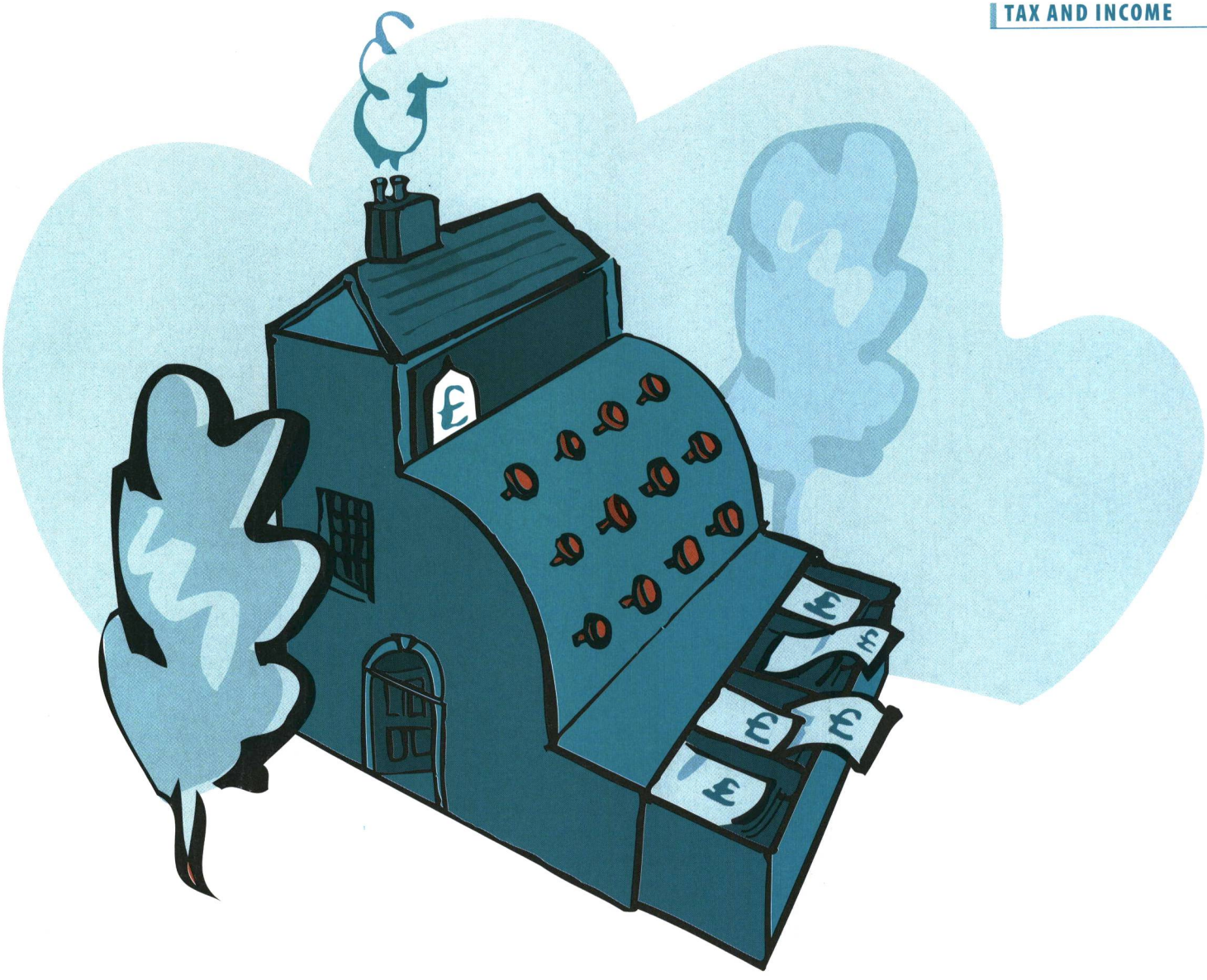
If the total rent you receive from your lodger exceeds £4,250, you can choose to stay with rent-a-room, or pay tax on your profits in the normal way (see 'Better off with rent-a-room', p35).

If you choose rent-a-room relief, you pay tax only on your gross rental income over the £4,250 limit, but you can't make any deductions for expenses. It is normally beneficial to do this only when your expenses are less than £4,250 (or £2,125 if shared).

If you have more expenses to offset, it may be better to opt out of rent-a-room and be taxed as you would with any other rental

IF YOU LIVE ABROAD

These days many people are retiring to a place in the sun, or moving abroad to work. While you're abroad you can let out your residence back in the UK to earn cash. However, special rules apply if you do this. Since 6 April 1996, letting agents (or tenants if there's no agent) of a non-resident landlord must deduct tax from the rent and pay tax each quarter to the Revenue. This only applies if the landlord's usual home is judged to be abroad. Individuals will not generally be judged as doing this if they are temporarily living outside the UK for six months or less. Non-resident landlords permanently living outside the UK can avoid having tax deducted by applying to the Inland Revenue Centre for Non-Residents (CNR) for agreement to receive rental income without tax deducted. For more information, call 0151 472 6208/6209, or look at the Revenue website www.inlandrevenue.gov.uk.



income. As you are paying tax after you've received the income, you can choose which method is better for you. There is nothing to stop you changing your decision from year to year.

Holiday lettings

Your property is treated as holiday accommodation if it is available for letting to the public on a commercial basis for at least 140 days during each 12-month period. It must actually be let for 70 or more of these days, and during at least seven of the 12 months no tenant may occupy it for more than 31 days in one go.

If you let furnished holiday accommodation commercially on a regular basis, you may be allowed some of the concessions given to business income. For this to apply, the lettings must always fulfil the rules above and you must agree this with your tax office.

BETTER OFF WITH RENT-A-ROOM

Bill charges his lodger Ben rent of £400 a month to share his house. This is more than the rent-a-room relief allowed, so Bill has a choice of how to deal with the income.

If he stays in the rent-a-room scheme, over a year £4,250 of Ben's rent will be tax free. That leaves £550 to be taxed at Bill's top rate of tax, which is 22 per cent. So he pays tax of £121 on Ben's rent for the year.

Alternatively, he can opt out of the rent-a-room scheme and opt to have the whole lot treated as ordinary rental income, which means he can deduct relevant expenses and only have the 'profit' taxed. However, at most, the expenses Bill could claim against the rent would come to about £1,000 for the year, which when deducted from the total rent received would leave him with a profit of £3,800 and a much bigger tax bill of £836 (22 per cent of £3,800).

Your home as a business

The third category of rental income is from rooms you let in your home as a business – a small hotel, guest house or bed and breakfast establishment.

The Revenue treats this as business income (rather than rental income) if you provide services such as meals and laundry that are beyond those normally offered by a landlord.

On your self-assessment tax return, enter income from a bed and breakfast or guest house on the supplementary pages for self-employment, not on the land and property supplementary pages. Interestingly, you can opt to claim rent-a-room relief if you own this type of establishment – see Inland Revenue helpsheet IR223 *Rent-a-room for traders*.

Any other rental income

Any other income you receive from letting houses, flats or land you don't live in yourself falls into this category. The same rules apply whether you let out one property or many, and whether the property is furnished or unfurnished. Overseas property you let out is broadly treated in the same way ▶

LETTING OUT A FLAT

Philippa Green has just moved to Essex, but rather than sell her old flat in Hove, she's decided to let it out. She had to seek permission from her freeholder and building society to do this, as her original leasehold agreement and mortgage was granted to her, not another person.

As she's so far away, Philippa has opted to manage the property through a letting agent rather than do it herself. This will cost Philippa money, but she can offset the letting agent's fees and the cost of advertising for tenants against her tax bill. Philippa's potential tax deductions don't stop there. As she has a mortgage on the flat, she can deduct the interest from the rent she receives as a deductible expense. The fact that the flat is furnished means that she can claim for wear and tear on the furnishing. Philippa hasn't decided yet whether to do it on a renewals basis or just use the simpler 10 per cent wear and tear allowance.

as income from property in the UK, but you must keep separate records and declare any income received from overseas property on the foreign income pages, not the land and property pages.

ALLOWABLE EXPENSES

You can offset certain expenses against rental income when you work out your profits, as long as they are wholly and exclusively incurred as part of renting out your property. If you let only part of your home, or let it out for only part of each year, you have to agree with the Inland Revenue the proportion of these expenses you can claim.

The most common allowable expenses are:

- water rates, ground rents and council tax
- normal repairs and decoration, but not improvements or additions
- wear and tear (see right)
- bills such as gas and electricity
- management expenses, such as phone bills, accountants' fees and the cost of rent collection
- legal fees when you renew a tenancy agreement
- insurance valuations and premiums
- estate agents' or letting agencies' fees and the cost of advertising for tenants
- the cost of services you provide, including the wages of cleaners and gardeners
- the cost of preparing an inventory
- interest on any mortgage on the property (but not repayment of capital).

MORE HELP

Inland Revenue booklets

IR87 Letting and your home

IR140 Non-resident landlords, their agents and tenants

IR150 Taxation of rents. A guide to property income

IR223 Rent-a-room for traders

Wear and tear

If property you let out is fully furnished, you can claim for wear and tear of furnishings such as cookers and carpets. This can be calculated on either a 'renewals' basis or 'wear and tear' basis. You can choose which basis to use, but you must stick to it for as long as you let that property.

With the renewals basis, you can claim the cost of any items replaced (excluding any extra items you buy and improvements you make).

Alternatively, the wear and tear basis allows you to claim 10 per cent a year of the rent, less council tax, water rates and other services you pay which would usually be paid by a tenant.

The possible advantages of the 10 per cent wear and tear allowance over the renewals allowance is that it is simple to calculate and you get a deduction each year.

Mortgage interest

If you have a mortgage on the property you let out, you can deduct all the interest you pay from the rent you receive as an allowable expense. If this leaves you with a minus figure, you have effectively made a loss, which you can carry forward and offset against future rental income.

Always tell your mortgage lender and insurers if you let rooms in your home, or let out your whole home. Failure to do so could breach the contractual agreements you have with both.

SERVICES

If you provide services, such as cleaning or laundry, and charge for them separately, the income you receive is not treated as rent, unless you are in the rent-a-room scheme. This income is assessed separately and you declare it on the land and property supplementary pages of the tax return. You may offset any expenses for providing these services against the income.

LOSSES

If you make a loss from your letting business, you can use it in different ways depending on whether it arises from furnished holiday lettings or another type of letting. For losses arising from furnished holiday lettings, you can offset your loss against any other income.

Otherwise, a loss on property in the UK can only be offset against income from any other properties in the UK. If you haven't got any other properties in the UK you can carry the loss forward and offset it against income from property in future, provided you're still letting the property you originally made the loss on. Losses on property abroad can't be offset against rental income from the UK.

PAYMENTS ON ACCOUNT

If you receive rental income, you'll probably have to make payments on account (see 'Payments on account', p37). You'll have to pay income for the 2002-2003 tax year in two equal instalments, the first on 31 January 2003 and the second on 31 July 2003.

Payments on account

You may have to pay some tax upfront, even before you know what your next tax bill will be. This is known as making payments on account.

Anyone who receives income that hasn't been taxed has until 31 January following the end of the tax year to pay the tax due. However, most people who have untaxed income are asked to make some interim tax payments before this date as advance payments towards their final tax bill.

WHEN DO YOU PAY THEM?

One payment is due on the 31 January falling within the tax year, and the other on the 31 July after the end of the tax year. For the 2001-2002 tax year the first payment was due on 31 January 2002 and the second on 31 July 2002. Any balance of tax will have to be paid by 31 January 2003, along with the first payment on account for the next tax year. On the tax return you get in April 2002, which relates to the 2001-2002 tax year, you will be asked to calculate the amount of the first payment of account you wish to make for the 2002-2003 tax year. This is due on 31 January 2003.

HOW MUCH IS EACH PAYMENT?

Normally each payment on account will be half your tax liability for the previous tax year, excluding tax deducted at source (eg PAYE) and capital gains tax. For example, if your total tax bill for 2000-2001 is £5,400, your first payment on account for the 2001-2002 tax year (due on 31 January 2002) will be £2,700. The second payment (due on 31 July 2002) will also be £2,700.

CALCULATING WHAT TO PAY

Taxpayers who work out their own tax liability also calculate their payments on account for the following tax year. Enter the amount of the first payment on account in box 18.6 of your tax return. You can, however choose to pay less than this – see 'Reducing the payments', right. If the Inland Revenue calculates your tax bill, it will send you a notice confirming your tax liability for the relevant tax year and, based on this calculation, your payments on account due for the next tax year.

MAKING THE PAYMENTS

Just before the first payment on account is due, you will receive a statement from your tax office which will have a payment slip for the first payment date. Even if you don't receive this statement, and you are one of the taxpayers who make payments on account, you remain responsible for making the first payment by the deadline.

The two payments on account will equal your previous year's tax liability (including Class 4 National Insurance contributions if you are self-employed), excluding tax deducted at source and capital gains tax. However, you can still elect to reduce them (see 'Reducing the payments', right).If the Revenue calculates your tax for you, and you don't agree or you don't understand how it reached the final figure, you should contact it straight away. Don't forget, your tax liability for tax year 2001-2002 affects what you pay in advance for tax year 2002-2003.

REDUCING THE PAYMENTS

Your payments on account are based on your own tax assessment. Even if the Revenue does the calculations for you, your tax bill is calculated using your figures for income, deductions and allowances. Payments on account are determined by your tax bill.

Therefore, if you want to reduce the payments you are due to make on account, you can do so, provided you have a good reason.

Why you might reduce your payments on account

If you think your tax bill for the next tax year is going to be less than it was for the last one, you can reduce the payments you make on account. But you must give a ▶

reason. This might be because:

- you know your business profits, rent or savings and investment income will be lower
- you have more tax allowances or tax reliefs
- you have more tax deducted at source.

How you reduce your payments on account depends on whether you calculate your own tax bill, or whether you ask the Revenue to do it for you.

If you calculate your own tax, you can apply to reduce your payments on account by ticking box 18.7 on your tax return. Make a reasonable estimate of the tax you expect to pay during 2002-2003 as opposed to the tax paid in 2001-2002 and reduce each payment to half this amount. Enter the amount you want to pay as the first payment on account in box 18.6 and, under the 'Additional information' section of your return, explain why you have reduced the payments.

If the Revenue calculates your tax, you will receive a statement of account before the first payment is due, and this will contain a claim form (form SA303), which you can use to reduce the payments on account you make. The form will ask you to confirm what payments on account you wish to make, and why you are reducing them. You should complete this and return it to your tax office. Alternatively, you can simply write to your tax office advising it that you want to reduce payments.

IF YOU PAY TOO LITTLE

If you have reduced your payments on account and your final tax bill turns out to be more than you have estimated, you will have to pay interest on any difference between the payments you have made and the payments you should have made. Interest will be charged from the date the payment of account was due – 31 January or 31 July (see 'Reduce your payments with caution', right). The Revenue charges you interest at a variable rate (6.5 per cent a year when we went to press).

In addition, there is a provision for penalties in the case of fraudulently or negligently made statements to reduce payments on account. The maximum penalty is 100 per cent of the difference between the payments that should have been made and the payments that were actually made. In the example below, if Ann had made her claim fraudulently or negligently, the maximum penalty would have been £1,922.

IF YOU PAY TOO MUCH

If you pay the amount asked for and your payments on account turn out to be more than the tax you owe, you will receive interest on any overpaid tax. Again, interest is paid from the date of payment at a variable rate set by the Revenue (2.5 per cent a year at the time we went to press).

REASONS FOR NOT PAYING

Even if you are self-employed, or have any untaxed income, such as rental income, there are two reasons why you might not have to make payments on account:

- if your total income tax in the previous tax year, less deductions, was £500 or less, or
- at least 80 per cent or more of the tax due for the previous tax year was deducted at source. So, if your total tax bill for 2001-2002 was, say £4,000, but £3,320 (83 per cent) was tax you paid via the PAYE system, you would not have to make payments on account for the balance of tax owed.

If either condition applies to you, you will have to make a single payment of the tax due on 31 January following the end of the relevant tax year (31 January 2003 for the 2001-2002 tax year). Alternatively, you can ask the Inland Revenue to collect the tax you owe via your PAYE code. But your tax office will do this only if you owe £2,000 or less and you file your tax return by 30 September after the tax year. If you don't want this tax to be deducted via PAYE, you must tick box 23.1 on the final page of the tax return (just above where you sign).

MORE HELP

Inland Revenue tax return guide, p33

Inland Revenue leaflets

SA/BK7 Self-assessment surcharges

SA/BK8 Self-assessment: your guide

REDUCE YOUR PAYMENTS WITH CAUTION

Although you can reduce payments on account, be careful not to underestimate, or you could be faced with a bill for additional interest, as our example shows. You might also have to pay a penalty.

In the 2000-2001 tax year, Ann Artist made a profit of £36,000 from her freelance design business and paid tax of £9,666. This meant that her payments on account for the 2001-2002 tax year were set at £4,833 due on 31 January 2002 and £4,833 for 31 July 2002.

However, because Ann had decided to work part time for a company as an employee, and only part time freelance, she estimated that her self-employed earnings would reduce to about £25,000 in 2001-2002. This would result in a tax bill of about £5,730, so Ann reduced her payments on account to half the estimated tax bill – ie £2,865.

In fact, Ann received a lot more freelance work than anticipated and by her year end had made a £32,000 profit, giving her a tax liability during 2001-2002 of £7,652. Ann will have to pay the balance of the tax due (£1,922) by 31 January 2003. As she underpaid each interim payment by £961, she'll also have to pay interest on the underpayments. Interest will be charged from the date the payment was due to the date the balance of tax owed is paid.

How Ann lost out		What Ann should have done	
If Ann pays her outstanding tax on 31 January 2003, she will be charged interest as follows on the underpayment:		If, on the other hand, Ann had made payments on account as requested, she would have received a tax refund of £2,014 and interest on her overpaid payments on account as follows:	
31 January 2002 payment: 12 months' interest on £961 x 6.5 per cent a year	£62.47	31 January 2002 payment: 12 months' interest on £1,007 x 2.5 per cent	£25.18
31 July 2002 payment: six months' (184 days') interest on £961 x 6.5 per cent a year	£31.49	31 July 2002 payment: six months' (184 days') interest on £1,007 x 2.5 per cent	£12.69
Total interest to pay on underpaid payments on account	**£93.96**	**Total interest received on overpaid payments**	**£37.87**

National Insurance

Most people don't consider National Insurance to be a tax – but that's what it is. The amount you pay is linked to what you earn, and your contributions are used to fund most of the social security system.

Some social security benefits (known as contributory benefits) are available only to people who have paid National Insurance. How much you pay determines how much you get back (this includes the basic state pension).

Most people who work pay National Insurance contributions (NICs) – but there are different 'classes' of NICs, depending on your employment status.

WHAT EMPLOYEES PAY

Employees have to pay NICs on all wages, salaries, commission, profit-related pay and overtime, as well as on sick pay and maternity pay from your employer. However, you don't have to pay contributions on fringe benefits or most expense payments. NI is worked out on your gross earnings, before deducting pension payments, donations to charity under a payroll-giving scheme, or income tax.

You pay a certain percentage of your earnings between a minimum and maximum known as the primary threshold and the upper earnings limit (UEL). The primary threshold is the same as the income tax personal allowance for both employees and employers – £87 a week in 2001-2002, £89 a week in 2002-2003. The UEL in 2001-2002 was £575 a week, and in 2002-2003 it's £585 a week.

If your earnings are below the primary threshold, you pay no NI. However, you still build up rights to benefits if you earn more than the lower earnings limit – £72 a week in 2001-2002, £75 in 2002-2003.

If your employer's pension scheme was contracted out of both Serps and its replacement, the State Second Pension (S2P), from April 2002, you will pay lower NICs of 8.4 per cent. You can decide to contract out of Serps individually (whether or not you are in an employer's scheme). In this case your NICs will remain at 10 per cent, but part of what you pay is rebated directly into your own personal pension arrangement (this will need to be organised by yourself). Any years you are contracted out don't build up a Serps pension entitlement.

WHAT EMPLOYERS PAY

In 2002-2003, employers pay NICs at 11.8 per cent on all their employees' earnings over the primary threshold. In 2001-2002 this was 11.9 per cent. There is no upper earnings limit. Unlike their employees, employers pay NICs on most taxable fringe benefits.

IF YOU'RE SELF-EMPLOYED

If you're self-employed, you pay Class 2 contributions unless your profits are less than £3,955 in 2001-2002 (£4,025 in 2002-2003). Below this level you can elect not to pay, but for any year you don't pay, you build up no entitlement to contributory benefits.

Class 2 contributions entitle you to incapacity benefit, bereavement benefits and state basic pension (but not S2P). You pay a flat-rate contribution of £2 a week.

Class 4 NI is paid on top of Class 2 if your taxable profits reach a certain limit. In 2001-2002 this was £1,775.55 – 7 per cent of taxable profits between £4,535 and £29,900. In 2002-2003, it will be £1,806.35 – 7 per cent of taxable profits between £4,615 and £30,420. If your profits are less than the lower limit, you pay only Class 2 contributions. Class 4 contributions do not entitle you to any additional state benefits.

VOLUNTARY NICS

You can pay voluntary Class 3 NICs to help qualify for the basic ▶

MORE HELP

Inland Revenue booklets

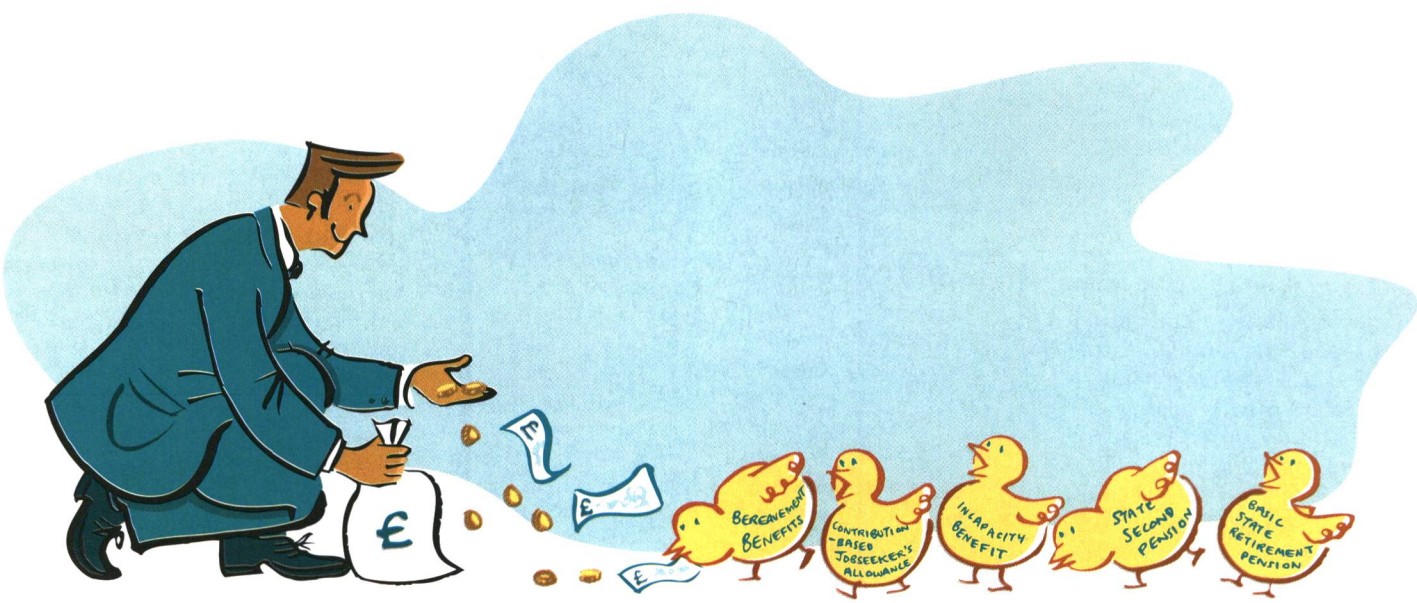
CA01 NI for employees

CA02 NI for self-employed people with small earnings

CA04 Class 2 and 3 NI contributions

Inland Revenue helpsheet

IR220 More than one business



retirement pension and bereavement benefits if: you are not working; you are not liable or exempt from Class 1 or Class 2 NI; your contribution record for a particular year isn't enough to count towards state pension entitlement; or you live abroad. The Class 3 rate is £6.85 per week for 2002-2003.

WHAT NICS BUY

Employees pay Class 1 NICs, which entitle them to the following contributory benefits: contribution-based jobseekers' allowance, incapacity benefit, basic state retirement pension, state second pension (S2P) and bereavement benefits.

To be eligible for contribution-based jobseekers' allowance (JSA), you must have paid or been credited with enough NICs. The important thing about contributory JSA is that it isn't means-tested. Contributory JSA is payable for up to six months and is taxable. Incapacity benefit pays out in the event of physical or mental illness. The contribution conditions are similar to those for JSA. If you claim incapacity benefit after April 2001 and you are receiving an employer's or personal pension, your benefit will be reduced by 50p for every £1 of pension, if the pension is over £85 a week. This means that, if your pension income is £105 a week, your incapacity benefit will be reduced by £10.

The basic state pension is also a contributory benefit. To receive the full basic pension you've got to pay NICs for 90 per cent of your 'working life' (49 years for men, currently 44 years for women). If you pay NICs for less than 25 per cent of your working life, you have no basic pension entitlement. The state pension calculator table, right, shows what proportion of the basic pension you will receive depending on the number of years you have paid NICs or received credits for them. Full rate Class 1 National Insurance contributions also pay for the state second pension (S2P), the replacement for the state earnings-related pension scheme (Serps). This scheme is designed to increase the retirement income of people who aren't in employers' schemes or other forms of private pension, and carers and disabled people. We look at these in 'Saving for your retirement', p53.

Bereavement allowance for both men and women was introduced in April 2001 to replace the widow's pension. A one-off payment of £2,000 is also available, but only if your late spouse wasn't entitled to the basic state pension or you were under the state pension age when your husband or wife died. The other bereavement benefit is widowed parent's allowance, paid from the time of death if the surviving partner is pregnant or is caring for dependent children. See 'You and your family', p57, for further information.

You may receive National Insurance 'credits', which can help you qualify for contributory state benefits, such as the basic pension, if you are not working. Credits are usually given automatically, but sometimes you need to apply for them. Home responsibilities protection also helps protect basic pension entitlement for people receiving child benefit for a child under 16, or regularly caring for a sick or disabled person. Ask your local benefits agency for details of when you need to claim.

STATE PENSION CALCULATOR

Years you've paid, or been credited with, NICs	Percentage of the full basic pension for which you qualify	
	Women born on or before 6 April 1950	Women born after 5 March 1955/all men
9 or less	0	0
10	26	0
11	29	25
12	31	28
13	34	30
14	36	32
15	39	35
16	42	37
17	44	39
18	47	41
19	49	44
20	52	46
21	54	48
22	57	50
23	59	53
24	62	55
25	65	57
26	67	60
27	70	62
28	72	64
29	75	66
30	77	69
31	80	71
32	83	73
33	85	75
34	88	78
35	90	80
36	93	82
37	95	85
38	98	87
39	100	89
40	100	91
41	100	94
42	100	96
43	100	98
44 +	100	100

CLASS 1 NICS

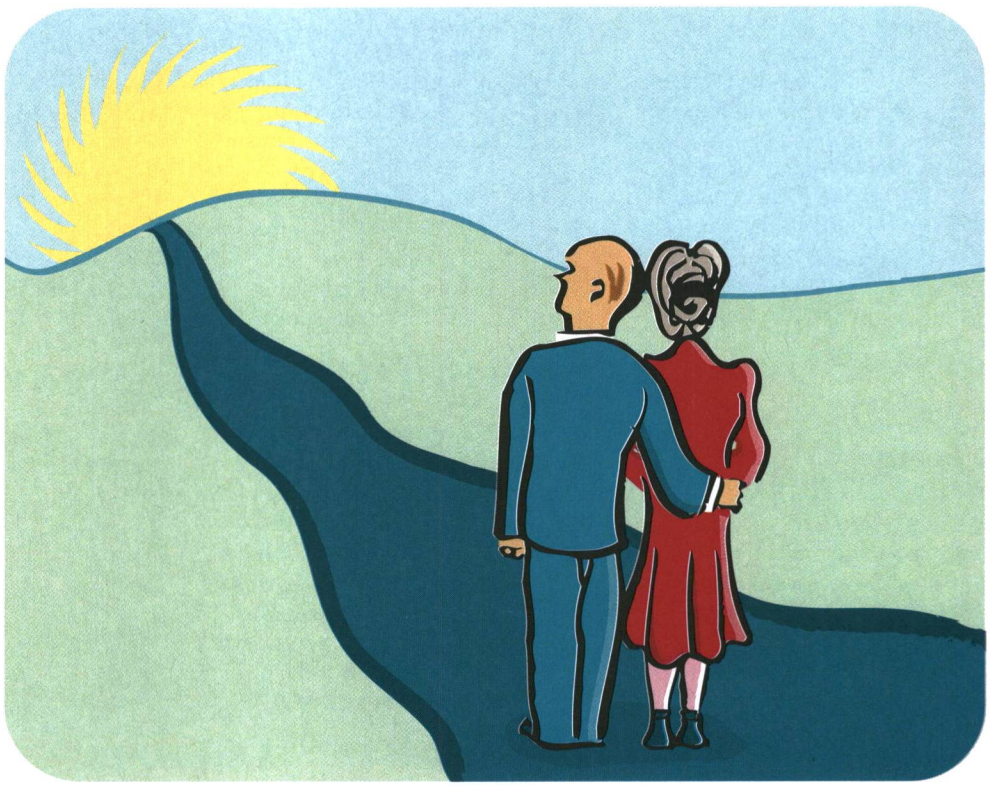
Class 1 NICs, 2002-2003	Employee (per week)
Lower earnings limit (level of earnings at which you start to build up entitlement to benefits)	£75
Primary threshold (level at which NICs become due)	£89
Upper earnings limit (maximum income on which NICs due)	£585
Rate paid if employer scheme is contracted into S2P	10% of earnings between £89 and £585 per week
Rate if employers pension scheme is contracted out	8.4% of earnings between £89 and £585 per week
Rate if paying married woman's option	3.85% of earnings between £89 and £585 per week

Married woman's option

Before 1977, married women could opt to be exempt from Class 2 contributions or pay a lower rate (3.85 per cent) of Class 1 contributions. Paying the married woman's option means that a wife has no right to build up her own basic state pension. Instead the 'couple' rate is paid to the husband for both of them. Even after the right to take the married woman's option was withdrawn, those who had chosen this option were allowed to continue. Around 100,000 women are still paying reduced contributions.

Tax for older people

As you get older, your tax position may change, entitling you to receive more income free of tax.



After you retire, your income is treated for tax purposes much the same as it was before your retirement age. The big difference is that, once you reach the age of 65, you may be entitled to receive more income before you have to start paying tax, and this is accounted for in your tax code.

EXTRA ALLOWANCES

Everyone gets a basic personal allowance. This is the amount of income you can receive free of tax each year. But if you turn 65 or 75 during the tax year, the allowance is increased and is known as age allowance.

Whether you qualify for the age allowance, and how much you are entitled to, depends on your total income. This is your gross taxable income, minus some tax-allowable deductions, such as payments to charity. Tax-free income, such as income from Isas or National Savings certificates, doesn't count against you when working out whether you're eligible for age allowance, but a gain from a taxable life insurance product (a single premium investment bond, say) might – even if the gain doesn't itself attract tax. If your total income exceeds a pre-set limit (£17,600 in 2001-2002, £17,900 in 2002-2003), your age allowance is reduced by £1 for every £2 that your income is over this limit. However, the allowance can never be reduced to less than the basic personal allowance.

In this section we also include a personal allowance calculator so you can work out whether you are eligible for age-related allowance. The calculator relates to the income limits set for the 2001-2002 tax year, but the method of calculation is the same for any year.

Even if your 65th birthday comes on the last day of the tax year (5 April), you can claim age allowance from the beginning of that tax year.

IF YOU ARE MARRIED

The married couple's allowance was abolished from 6 April 2000, unless you or your spouse were born before 6 April 1935. If you married after the allowance was abolished, but you or your husband or wife were born before 6 April 1935, you can still claim it. You can choose for the minimum allowance (not the higher amount related to age) to be allocated to either spouse, or split between you, but if no choice is made, the allowance will always be given to the husband. The allowance given is always based on the husband's total income, even if:

- he qualifies only because of his wife's age
- all or part of the minimum married couple's allowance has been transferred to his wife and her total income exceeds £17,600 (for tax year 2001-2002, £17,900 for 2002-2003).

If a married man's income exceeds the limit allowed for age allowance, it is his age-related personal allowance that is reduced first. Once that has been reduced to the level of the basic personal allowance (£4,535 in 2001-2002, £4,615 in 2002-2003) he starts to lose the age-related married couple's allowance. Married couple's allowance can never be reduced to below the level of the minimum allowance (£2,070 this tax year, £2,110 for 2002-2003). ▶

EXTRA ALLOWANCES

	2001-2002 tax year (£)	2002-2003 tax year (£)
Personal allowance		
Basic	4,535	4,615
Age-related: if you're 65 to 74	5,990	6,100
Higher age-related: if you're 75 or over	6,260	6,370
Married couple's allowance[1]		
Minimum amount	2,070	2,110
Age-related: either spouse 65 to 74	5,365	5,465
Higher age-related: either spouse 75 or over	5,435	5,535

1 Relief restricted to 10 per cent. Allowance abolished from 6 April 2000 for most taxpayers. It remains for married couples where one or both parties was born before 6 April 1935 or where one person born before 6 April 1935 marries on or after 6 April 2000

HOW MUCH TAX RELIEF?

The married couple's allowance isn't an amount you can receive tax free (like the personal allowance). Instead, 10 per cent of the allowance is offset against the tax you owe – reducing your final tax bill. For the 2002-2003 tax year, if you are between 65 and 74, the married couple's allowance is worth up to £546.50 off your tax bill. If you are 75 or over, it's worth up to £553.50. The minimum married couple's allowance is worth only £211.

KEEP YOUR INCOME DOWN

If your income looks as though it will exceed the total income limit, and it will cause you to lose age-related allowances, think about which investments you choose. You may be able to keep within the total income limit if, say, you switch to a tax-free investment such as an Isa or National Savings certificate.

You could also consider giving regularly to charity through Gift Aid to keep your income down. With the new Gift Aid scheme, in force from 6 April 2000, it's even easier to give to charity, and donations through the scheme are treated as tax-allowable deductions for the purpose of reducing your total income for age allowance. For example, if in 2002-2003 you gave £156 a year to charity via Gift Aid, the charity could claim £44 from the Revenue. This (grossed-up) gift would reduce your total income by £200.

You could also consider putting income from investments into joint names or even transferring it entirely to your husband or wife if they have a lower taxable income.

TAX ON STATE PENSIONS

When state pensions are paid to you, you'll find it's without tax deducted, but that doesn't mean they are free of tax. All pensions you receive from the state are totalled up and added to your other taxable income to determine what tax you pay. How many years you worked and what age you retire will determine the amount and type of state pension you are entitled to.

TAX ON YOUR EMPLOYER'S PENSION

Tax on a pension from a former employer will normally be collected under PAYE (see p17) and will already have been deducted before you receive it. When you first receive the pension, it might appear that it is being taxed at a higher rate than your earnings were before you retired. This is because the tax deducted takes into account other income that is taxable but paid before tax, such as the state pension.

MORE HELP

Inland Revenue leaflet

IR121 Income tax and pensioners

DSS leaflet

NP46 A guide to retirement pensions

PAST STATE PENSION AGE

If you work past state pension age, your state pension is simply added to your other taxable income for tax purposes (unless you've deferred it, see p53).

NATIONAL INSURANCE

Once you reach state pension age, you don't have to pay any more Class 1 (employed) or Class 2 (self-employed) National Insurance contributions (you have to pay Class 4 contributions until 5 April following the state pension age). The DWP will send you form CF384 when you claim your state pension.

OTHER TAX RELIEFS

There are some other tax reliefs that were abolished in March 1999 but still apply for some taxpayers.

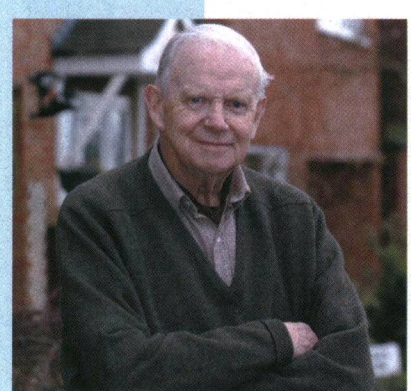
Home income plans

People who were 65 and over received tax relief if they took out loans secured on their home and used the money to buy an annuity. These loans qualified for tax relief at the basic rate of tax – but only on the interest up to £30,000. Relief was withdrawn for new schemes from 9 March 1999, but borrowers who qualified for tax relief at that time continue to receive this relief.

Maintenance relief

You can claim some tax relief on any qualifying maintenance payments you make, provided you or your former husband or wife were born before 6 April 1935. If you are still eligible for tax relief, you can claim 10 per cent of the maintenance allowance as a deduction on your tax bill. The allowance is £2,070 for 2001-2002, (£2,110 for 2002-2003) or the amount of your qualifying payments, if less. So the maximum deduction for tax relief is £207 for 2001-2002 (£211 for 2002-2003).

OVER THE LIMIT



William Stewart, who is 80, is entitled to higher tax allowances because of his age. However, last year his income exceeded the limit allowed before age-related allowances start to be reduced. William knew he would lose some of the extra allowance, but couldn't work out how his tax office had applied the reduction.

For tax year 2001-2002, the income limit was £17,600, but William earned £26,000 so was £8,400 over this. You lose £1 of allowance for every £2 of income above the limit, which meant William's age-related allowances had to be reduced by £4,200 (half the excess). The personal allowance is the first to be reduced. Last year William was entitled to an age-related personal allowance of £6,260 and this was reduced down to the basic personal allowance for 2001-2002 (£4,535). This used up £1,725 of the surplus. The remaining surplus (£2,475) was applied against William's age-related married couple's allowance, which reduced it from £5,435 to £2,960. Ten per cent of the married couple's allowance is given as a reduction in your tax bill, so this meant William's lower married couple's allowance entitled him to a £296 reduction in his tax bill.

PERSONAL ALLOWANCE CALCULATOR

This calculator shows whether you're entitled to full age-related allowance. If you're not, it works out how much you are entitled to.

How to use it
You need to know your total income (broadly, taxable income less some outgoings).

Work out your taxable income (**1**) and subtract your outgoings (**2**). Remember to enter gross figures – income before any tax is deducted (ignore tax-free income) and outgoings before any tax relief has been worked out. If your total income (**3**) comes to £17,600 or below, you get the full age-related allowances shown in the table on p41.

Reduced allowance
If your total income is more than £17,600, use the calculator to work out what proportion of the age-related allowance you're entitled to.

If you earn more than the limit shown at **step 4**, you get no age-related allowance.

If you earn between £17,600 and the relevant limit, use **step 5** to work out how much you get.

1 Taxable income: add up your before-tax income for the tax year 2001-2002

Income from your job or business Don't include contributions to an employer's pension scheme, payroll giving donations and allowable expenses, but include taxable perks and amounts reimbursed for expenses (but only if there is a profit element)

Income from pensions

Income from taxed and taxable investments

Other income (such as income from property)

Income sub-total

2 Outgoings: add up the gross amount of tax-allowable payments

Charitable giving under Gift Aid or a deed of covenant started before 6 April 2000

Pension contributions that qualify for tax relief

Qualifying loan interest but not interest to buy your only or main home

Outgoings sub-total

3 Work out total income

Deduct total outgoings from income

4 Check whether your total income is above limit shown

If your total income is above the income limit shown below, you get no age-related allowance. If it is between £17,600 and the limit, you will get a reduced amount of allowance – see step 5 for the amount.

Find the appropriate income limit for someone of your age and marital status in the table below. Use the right-hand columns ONLY if you are eligible for age-related married couple's allowance, ie you are married and you or your spouse were born before 6 April 1935. Married couple's allowance was abolished on 6 April 2000, and now applies only to couples where one spouse reached the age of 65 before that date. Note: ages shown below refer to age on last day of tax year (5 April 2001) – see 'Warning', right.

Single person, married woman, or married man born between 6 April 1935 and 5 April 1937	Income limit	Married man aged	Income limit
Aged between 65 and 74	£20,510	64 or younger, wife aged between 65 and 74	£24,190
Aged 75 or over	£21,050	64 or younger, wife aged 75 or over	£24,330
		between 65 and 74, wife aged under 75	£27,100
		between 65 and 74, wife aged 75 or over	£27,240
		75 or over, wife any age	£27,780

5 Work out your allowance

Deduct £17,600 from your total income

Divide the result by two. This is the reduction in your overall age-related allowances (**R**). **R**

Enter the maximum personal allowance for your age (**P**) in the box marked 'Personal'. If you are still eligible, enter the married couple's allowance for the older of you and your wife (**M**) in the box marked 'Married'. Personal **P** Married **M**

To work out your reduced personal allowance, deduct **R** from **P** to give **A**. If **A** is £4,535 or more, this figure is your reduced personal allowance. If **A** is less than £4,535, your reduced personal allowance is £4,535. If you're a married man, and **A** was less than £4,535, work out the difference between **A** and £4,535 and enter it at **B**. **B**
Subtract **B** from **M** and write the larger of this and £2,070 in the box marked **C**. This is your reduced married couple's allowance (it's reduced further if you married during the year). **A** **C**

WARNING
It is always the husband's total income that is used to work out married couple's age allowance. This applies even if the husband has transferred married couple's allowance to his wife and even if they are entitled to the extra allowance because of her age, not his.

However, when a married man starts to lose age-related allowance, it is his personal allowance which is reduced first. When it has been reduced to £4,535, he may then start to lose the extra married couple's allowance.

WARNING
If you married during 2001-2002, you can claim the allowance only if you or your spouse were born before 6 April 1935.

Savings and investments

Taxable, taxed and tax free... Different savings products have different tax rules. This chapter explains the current rules.

Income tax on savings income (as opposed to income from employment or self-employment or rental income) can be paid at three rates – 10, 20, and 40 per cent – depending on the tax band the income falls into when added to your other taxable income.

For example, if all your income (including your savings income) when added together is below the level of the starting-rate band (£1,880 in tax 2001-2002), you will pay 10 per cent on your savings income. If your total income falls into the basic-rate tax band (£1,881 to £29,400), you will pay 20 per cent tax on the part of your income that comes from savings or investments. This is a different rate from the basic rate of tax applied to non-savings income, which is 22 per cent. Any income which falls into the higher-rate tax band (over £29,400) attracts tax at 40 per cent, whether it is savings or non-savings income. Tax band limits change each new tax year. The 2002-2003 bands had not been announced when we went to press.

Income from savings or investments can be taxed in three different ways: taxable and paid 'gross' (that is, paid in full, without tax deducted), taxable and paid 'net' (paid after tax has been deducted), and tax free. We explain each type in this chapter. The table on p46 shows how a range of investments is taxed.

TAXABLE AND PAID GROSS

Although income on the following types of investments is paid gross (that is, without tax deducted), you have to declare it and pay tax, unless you're a non-taxpayer.

National Savings

Interest on Capital Bonds, Income Bonds, Investment Accounts and Pensioners' Bonds are all paid gross. The same is true for the Ordinary Account (but see p46).

Gilts

The interest on gilts (short for gilt-edged securities – another name for government stocks) acquired since 6 April 1998 is paid gross, but you can ask to have it paid net of tax. Gilts bought before that date continue to pay interest net, unless you choose to be paid gross.

If you buy or sell gilts, you may come within the accrued income scheme. If so, part of the price that you get when you sell may be taxable as the equivalent of interest. But your first interest payment received may be reduced for tax by any interest accrued and reflected in the price when you bought the stock. This also applies to other interest-bearing securities such as local authority bonds, corporate bonds and permanent interest-bearing shares issued by building societies (PIBS).

However, the accrued income scheme doesn't apply if the nominal or face value of all accrued income scheme securities held doesn't exceed £5,000 in the tax year up to the time that you sell them, and throughout the previous tax year.

Offshore accounts

interest on offshore accounts and investment funds, such as those based in Dublin or the Channel Islands, is paid gross but this doesn't mean it's tax free. If you are UK resident, then you are normally charged on the full amount of foreign income arising abroad, whether it is brought into the UK or not. Declare this type of income on your tax return using the special pages for foreign income.

TAXABLE AND PAID NET

Tax on income from certain investments and savings (for example, building society and bank interest) is usually deducted at source by the provider, who pays it to the Inland Revenue.

Basic-rate taxpayers have no further liability. Starting-rate taxpayers may be able to claim back half of the tax, and non-taxpayers all of the tax (but see 'Shares and investments', right).

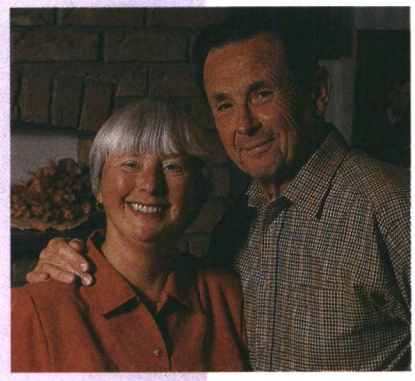
BONUSES ON ISAS ARE TAXABLE

Phillip Trow and his wife Jennifer both had mini cash Isas with Britannia Building Society.

Britannia pays an annual 'mutual bonus' to members. You gain one point for each £100 invested, and double if you've been a member for over 10 years. For Phillip and Jennifer this was effectively worth 0.44 per cent on their Isa balances.

However, when Phillip and Jennifer received their bonus statements, they received a nasty shock. Britannia had taxed the bonus along with their other taxable investments. After receiving no reply on the subject from Britannia, Phillip contacted us.

Sadly, in this case Britannia was right to tax the bonus. Bonuses of this kind would be received whether the money was held in a cash Isa or a taxable account. As a result, the bonus is not an intrinsic part of the cash Isa, and is therefore taxable.



If you are a non-taxpayer, you can also register to have your bank and building society interest paid gross – you'll need form R85, available from your bank or building society or from any Inland Revenue office or enquiry centre.

However, if, after totalling all your income (including the before-tax value of investment income), you become liable for tax at the higher rate, you have to pay extra tax. Declare it on your tax return or through your PAYE code.

UK LIFE INSURANCE

There are two types of life insurance policy – the income from each is treated slightly differently.

Qualifying policies

Most regular premium policies, such as whole-of-life insurance and most endowment policies lasting ten years or more, are qualifying policies. Provided you keep them for at least ten years (or, if less, three quarters of their term), you pay no tax on the proceeds – the provider has already paid tax that you can't reclaim (equivalent to the basic rate) on the underlying investment. However, if you stop the policy before then, you may have to pay additional tax, but only if you make a gain on the policy.

Non-qualifying policies

Providers pay tax on underlying investments in non-qualifying life policies such as single-premium investment bonds. This covers your liability to basic-rate tax. However, higher-rate taxpayers pay 18 per cent more tax (the difference between basic- and higher-rate tax) when they cash in the policy or if they make a gain by withdrawing more than 5 per cent of the original investment in a tax year.

SHARES AND INVESTMENTS

Shares, investment trusts, open-ended investment companies (Oeics), and authorised unit trusts may pay you an income.

The Inland Revenue treats dividends from UK shares and distributions from Oeics and authorised unit trusts as being paid with a tax credit of 10 per cent. This tax credit should be shown on your dividend or distribution voucher. The tax credit meets the tax for starting- and basic-rate taxpayers so that they pay no more tax. Higher-rate taxpayers pay a further 22.5 per cent. Non-taxpayers can't claim this tax credit back. If you switch your investment into an Isa (see right), the tax credit can be claimed by the Isa manager at least until 2004, whatever your tax status.

You can often choose to reinvest your income, in which case it is treated in the same way as if you received the dividend as cash.

When you invest in an Oeic or authorised unit trust, though, part of the price may reflect income that has accumulated in the fund. This 'equalisation payment' is refunded to you as part of the first distribution you receive. You do not have to declare equalisation payments on your tax return as they are treated as returns of capital and aren't taxable. They should be deducted from your initial investment for capital gains tax purposes.

MORE HELP

Inland Revenue leaflets

IR68 Accrued income scheme

IR110 A guide for people with savings

IR2008 Isas, Peps and Tessas

TAX-FREE INVESTMENTS

The main tax-free investments that you can have are individual savings accounts (Isas) and certain National Savings products.

You can no longer open a new Pep or Tessa. You can, though, transfer existing Peps and Tessas from one manager to another.

You can't pay more money into a Pep or transfer it to an Isa. But if you have a current Tessa, you can continue to contribute to it (up to £1,800 each tax year subject to the overall £9,000 limit) until the end of the five-year term is reached. The capital from a maturing Tessa can be transferred to a cash Isa without affecting your other Isa allowances. This can be through a separate cash Isa set up exclusively for this purpose and known as a 'Tessa-only Isa'.

INVESTING IN ISAS

The higher investment limits for individual savings accounts (Isas) have been extended until the tax year ending 5 April 2006. So you can pay in up to £7,000 each year for the next four tax years.

The three types of Isa investment are: cash (for example, savings accounts with banks or building societies); share-based investments (shares, unit trusts, and so on), and life insurance (normally investments into life offices' funds such as with-profit funds).

You can choose to have all the components in one Isa, known as a maxi Isa (although few providers offer all three or even two components), or each part can be a separate mini Isa, which can be with different providers. You ▶

can't invest in a maxi and a mini Isa in the same tax year, or open two Isas of the same type – say, two mini cash Isas. The annual limits for mini Isas are £3,000 cash, £3,000 stocks and shares and £1,000 life insurance. These apply to what you pay in, not your balance. So if you put £3,000 in a mini cash Isa, you have used up your allowance – if you withdraw £100, you can't pay it back in later during the same tax year.

Income and gains from an investment in an Isa are free of income and capital gains tax (but see our case study, p45). In the share-based component, the Isa manager can also claim a 10 per cent tax credit on UK dividends, but only until 5 April 2004. However, there will still be no personal liability to income tax or capital gains tax for Isa holders.

Isas are only available to UK residents. Anyone aged 16 or over can take out a cash Isa but you have to be 18 or over to take out a share or insurance Isa.

NATIONAL SAVINGS

Several National Savings products are tax free. These include the National Savings cash Isa and the investments detailed here. National Savings rates appear every four months in 'Savings monitor' in *Which?* or go to the National Savings website at www.nationalsavings.co.uk.

Savings Certificates

The two types of certificate, fixed-interest and index-linked, are both tax free. The minimum purchase for both is £100. New issues come out fairly frequently and the most you can buy of each is £10,000. You can also reinvest, with no limit, the proceeds of matured certificates from previous issues.

Fixed-interest certificates pay a guaranteed income over two or five years. The return on index-linked certificates is a fixed percentage on top of the annual increase in inflation, as measured by the retail prices index.

HOW INCOME IS TAXED IF YOU'RE A UK RESIDENT

Type of income	Tax status			
	Taxable	Taxed	Tax free	Notes
Accounts (held in £ or foreign currency) at a UK branch of a bank or building society		✓		see[1]
Accounts at an offshore (eg Jersey, Isle of Man) branch of a UK or foreign bank or building society	✓			
Annuities		✓		see[1]
British government stocks (gilts) on the National Savings Stock Register	✓			see[2]
Other British government stocks		✓		see[2]
Co-operative Society deposits	✓			
Corporate bonds, debentures, loan stock and other fixed-income investments		✓		see[3]
Friendly society tax-exempt plans (eg baby bonds)			✓	
Interest from private individuals	✓			
Interest on distributions under a will		✓		
Isas			✓	
Loans to foreign governments		✓		see[4]
Local authority loans		✓		see[1]
National Savings Ordinary Account:				
• first £70 (£140 joint account)			✓	
• remainder	✓			
National Savings Certificates			✓	
National Savings Children's Bonus Bonds			✓	
National Savings First Option Bonds		✓		
National Savings: other accounts and bonds	✓			
Offshore managed funds	✓			
Open-ended investment company distributions		✓		see[5]
Permanent interest-bearing shares (PIBS)		✓		see[3]
Personal equity plans (Peps)			✓	
Premium Bond prizes			✓	
Proceeds from qualifying life insurance policies (usually)			✓	see[6]
Save-as-you-earn accounts			✓	
Share dividends from UK companies		✓		see[5]
Tax exempt special savings accounts (Tessas)			✓	see[7]
Tax rebate interest			✓	
Traded options				see[8]
Trusts and settlements: payments to beneficiaries		✓		
Unit trust distributions		✓		see[5]
War loans	✓			see[2]

1 Non-taxpayers can receive this gross
2 No capital gains tax to pay
3 No capital gains tax if they count as qualifying corporate bonds
4 If in foreign currency, may be received gross but taxable
5 Profits on sale taxed as capital gains
6 But insurance company has paid tax which cannot be reclaimed. With non-qualifying policies, higher-rate taxpayers have to pay extra tax
7 Tessas must be kept for five years
8 Taxed as capital gains unless linked to gilts or qualifying corporate bonds

Children's Bonus Bonds

Anyone over 16 can buy these for children aged under 16. They are sold in units of £25 and can be held for up to five years. They can be cashed in with one month's notice but pay a bonus if held for five years.

You can reinvest Children's Bonus Bonds after five years but they mature at the holder's 21st birthday and no further returns are earned after that time. Returns are tax free and don't affect parents' tax liability, even if they pay for the bonds. The maximum holding of the current issue is £1,000 a child, in addition to holdings of earlier issues.

Ordinary Account

Although the rates of interest on the account are low (as at 13 February 2002, 0.5 to 0.6 per cent depending on the amount invested), the first £70 of interest (£140 with joint accounts) is free from tax, and it offers instant access from any post office for small withdrawals. Any interest above the tax-free limit is taxable, and there is a maximum holding of £10,000. However, given that interest is so low, you are probably better off with an ordinary taxable savings account.

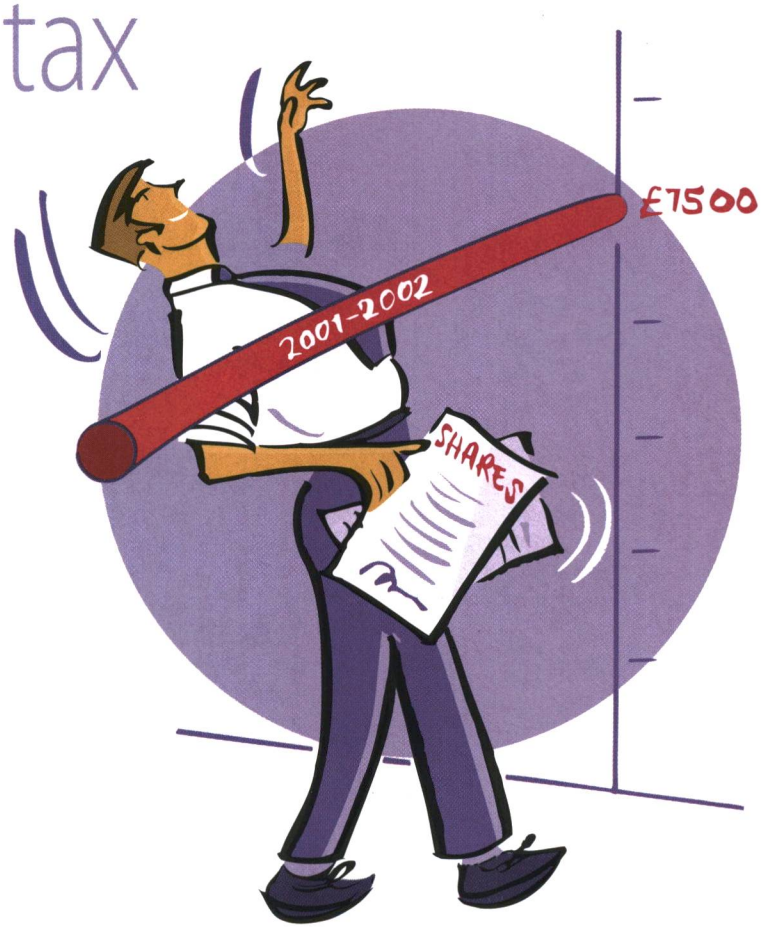
Premium Bonds

These do not pay interest, but are included in a monthly prize draw after you've held them for one month. Winnings are free of income and capital gains tax. You can cash in the bonds at any time at face value.

FRIENDLY SOCIETY PLANS

Friendly societies offer tax-free insurance plans that must last at least ten years. Unlike other insurance policies, the society pays no tax on the underlying investment, but charges can be high, especially in the early years. Some societies market their plans to people investing for children up to age 18 or 21. You can invest up to £270 a year if paid in a lump sum, or £300 a year if you pay monthly.

Capital gains tax



Whenever you dispose of an asset, for example, by selling it or giving it away, you may be liable for tax.

Basically, an asset is anything you own. There's no capital gains tax (CGT) to pay on your estate when you die, but there may be inheritance tax (see 'Gifts and bequests', p60).

HOW MUCH TAX?

Tax is based on the increase in value of the asset during the time you owned it. This is calculated by taking the final value of the asset when you disposed of it and subtracting the initial value when you acquired it, along with any allowable expenses.

In general, only gains or losses since 31 March 1982 are taken into account, and some gains are tax free. The first slice of capital gains (£7,500 in the 2001-2002 tax year) is also free of tax. The calculator, p50, will help you work out how much tax you have to pay.

Your taxable gains are treated as the top slice of your income. The rate of tax you pay depends on which tax band your taxable gains plus your other taxable income falls into. For 2001-2002, if your total taxable income and gains are below £1,880, you pay 10 per cent tax; on gains that fall in the basic-rate tax band (between £1,881 and £29,400) you pay 20 per cent tax; and for gains that fall into the higher-rate band (over £29,400) you pay 40 per cent.

LOSSES

If you make a loss on the sale or transfer of an asset, you must offset it against any gains you make in the same year. If, after using your current year losses, you still have gains above the tax-free slice, you must use losses made in any previous years to reduce your gains to the level of the tax-free amount. You can't offset losses on assets or transfers that are exempt from capital gains tax, such as Peps or Isas (except for losses on Enterprise Investment Scheme shares).

GLOSSARY

Allowable expense Some costs of acquiring or disposing of assets (such as commission, legal fees, stamp duty and advertising) can be deducted from your gains.

Final value This is an asset's sale price or market value at the time you sell it or give it away. If you sell for less than the market value, the final value is usually the market value.

Initial value The price paid for an asset, or its market value when you received it (you may need to agree this with your tax office).

Unused losses

Any losses that you haven't used against gains can be carried forward indefinitely to future years, irrespective of when you made the loss. You must notify the Revenue of losses if you intend to carry them forward. You can do this either on the capital gains tax pages in your tax return or by letter. You have just under six years from the end of the tax year in which you make the loss to do this – so until 31 January 2008 for losses made in 2001-2002.

There is no time limit for notifying the Revenue about losses made before 6 April 1996.

TAX-FREE GAINS

The main assets and transactions that are free of CGT, subject to certain conditions, are:

- your only or main home (but see p52)
- private motor cars
- betting, lottery or pools winnings
- British Government stocks (gilts), qualifying company loan stock and building society permanent interest-bearing shares (PIBS)
- 'cashbacks' when you buy something
- gifts to charities and National Heritage bodies
- National Savings, Tessas, Peps and Isas
- shares in a Venture Capital Trust
- shares held through an Enterprise Investment Scheme (or earlier Business Enterprise Scheme)
- proceeds from life insurance policies, unless they're bought second-hand
- personal injury compensation
- compensation because you were mis-sold a personal pension between 29 April 1988 and 30 June 1994
- personal possessions with a useful life of 50 years or less from the date you acquired them. For possessions with a longer life, see Inland Revenue helpsheet IR293 *Chattels and CGT*.

REDUCING YOUR BILL

The CGT rules have changed several times, the most radical change being the replacement of ▶

indexation allowance by taper relief in April 1998.

Indexation allowance

This applies to assets acquired before 1 April 1998. It means that you are not taxed on gains in line with inflation between the date of acquisition (or March 1982 if later) and April 1998. Your initial value and allowable expenses are linked to the retail price index (RPI) and increased in line with the index. The effect is that your taxable gain is reduced or eliminated. However, you can't use indexation to create or increase a loss.

Taper relief

Taper relief reduces the chargeable gain depending upon the length of the time you've owned the asset after 5 April 1998. Within limits the longer the asset is held, the smaller the proportion of any gain you pay tax on – effectively reducing the level of CGT you pay (see the table, below).

The amount of taper relief depends on whether an asset has been a business asset or not – taper relief is more generous for business assets. For disposals after 5 April 2002, the Chancellor has proposed still more generous treatment, with the percentage chargeable falling to 50 per cent after one year, and 25 per cent after two.

You must own a non-business asset for at least three years and a business asset for at least one year after 5 April 1998 before taper relief reduces your tax bill. However, non-business assets held before 17 March 1998 have an extra year added to the period of ownership that qualifies for taper relief.

This means that non-business assets held before 17 March 1998 and disposed of after 5 April 2001 and before 6 April 2002 have four years' qualifying ownership, and so only 90 per cent of the gain on these assets will be liable to tax.

Losses and taper relief

Any losses must be offset before you apply taper relief. In practice, this means that you will get the benefit of taper relief only if the remaining untapered gain is greater than the tax-free slice.

However, you must allocate losses to gains that qualify for the least amount of taper relief first – this ensures you make the most of your taper relief.

Business assets

For the purpose of taper relief, a business asset is:

- an asset used in a trade carried on either by you or by your qualifying company
- an asset owned by the employee of a trading business for use at work
- shares or securities you own in your qualifying company.

For periods of ownership from 6 April 2000, a company is your 'qualifying' company if it is:

- an unquoted trading company, or
- a quoted trading company in which you can exercise at least 5 per cent of the voting rights, or
- a trading company for which you work, or
- a non-trading company which employs you, provided you do not have an interest of more than 10 per cent of the company.

For periods of ownership before 6 April 2000, the definition was more restrictive. If an asset has been both a business and a non-business asset, the gain is split between the two taper relief rates. See Inland Revenue helpsheet IR279 *Taper Relief*.

HOW TAPER RELIEF WORKS

If you bought a non-business asset (a painting, say) in 1987 that you sold in July 2001 for a profit of £1,404 (after deducting indexation allowance up to April 1998 and any allowable losses), this is how taper relief would apply:

Your net gain	£1,404
Complete number of years asset held after 5 April 1998 (including extra year as asset was held before 17 March 1998)	4 years
Percentage of gain chargeable for non-business assets (with qualifying period of four years)	90%
Net chargeable gain is 90 per cent of £1,404	£1,263

If you'd used up your capital gains tax-free slice, you'd pay £126.30 capital gains tax on this gain if you were a starting-rate taxpayer, £252.60 if you were a basic-rate taxpayer, and £505.20 if you were a higher-rate taxpayer. This is equivalent to paying capital gains tax at 18 per cent for basic-rate taxpayers (36 per cent for higher-rate taxpayers) on the original gain of £1,404.

Gains on business assets			Gains on non-business assets	
Complete years after 5 April 1998 that asset was held	Percentage of gain that is chargeable – the taper (%)	Equivalent CGT rate for higher-/basic-rate taxpayers – 40/20% times the taper	Percentage of gain that is chargeable – the taper (%)	Equivalent CGT rate for higher-/basic-rate taxpayers – 40/20% times the taper
0 years	100	40/20	100	40/20
1 year	87.5	35/17.5	100	40/20
2	75	30/15	100	40/20
3	50	20/10	95	38/19
4	25	10/5	90	36/18
5	25	10/5	85	34/17
6	25	10/5	80	32/16
7	25	10/5	75	30/15
8	25	10/5	70	28/14
9	25	10/5	65	26/13
10+	25	10/5	60	24/12

CGT ON SHARES

Unless held in a tax-exempt scheme such as an Isa, gains on shares and unit trusts are liable to CGT in the normal way, but some special rules apply. The main ones are explained below, but for full details see 'More help', p52.

If you acquire shares of the same type in the same company (or units in the same unit trust or Oeic), but at different times, they look identical. So, to work out the initial value and taper relief, the Revenue treats you as disposing of your shares in the order shown in the table, right. See Inland Revenue helpsheet IR284 *Shares and capital gains tax*.

Scrip dividends

These are paid in the form of shares rather than cash. They are treated as a new acquisition at the dividend date, if received after 5 April 1998 (for earlier dividends, see Inland Revenue helpsheet IR285). The dividend voucher usually shows the allowable cost.

Rights and bonus issues

Extra shares you receive under a rights or bonus issue count as belonging to the same holding as the original shares to which they relate. Shares issued after 5 April 1998 have the same acquisition date and initial value as the original shares. However, if the shares were issued before then, or different classes of shares were involved, see Inland Revenue helpsheet IR285 *Share reorganisations*.

The company issuing shares will usually give details of the tax treatment in the circular or prospectus.

Takeovers and mergers

If you exchange your shares for new shares due to a takeover or merger, it won't normally count as a disposal. The new shares simply stand in place of the old. If you exchange your old shares for new shares and cash, you're assumed to have disposed of a proportion of your old shares (the percentage of the exchange represented by cash) – that is, unless the cash received is less than £3,000 or not more than 5 per cent of the value of the shares in the original company. If this is the case, the allowable cost of your original shares is reduced by the amount of cash.

WHICH SHARE HAVE YOU SOLD?

Shares of the same type in the same company acquired at different times are treated as disposed of in this order

	When acquired	What happens
1st	Shares acquired on same day as sale	No effect – simply cancels out sale
2nd	Shares acquired within the 30 days after the disposal	This reduces the appeal of 'bed and breakfasting' – selling shares and buying them back in order to realise a gain to use up your tax-free slice. Taking the price at which you buy back as the initial value means you won't realise a gain unless prices fall
3rd	Shares acquired after 5 April 1998	Treated as if you sold your most recent acquisitions first
4th	Shares acquired between 6 April 1982 to 5 April 1998	Shares are pooled – the cost of each share in the pool is the average cost of acquiring them. The value of the pool is adjusted for indexation each time you add shares or take them away
5th	Shares acquired between 7 April 1965 to 5 April 1982	Pooled as above, but kept in a separate pool
6th	Shares acquired before 6 April 1965	You have a number of choices – ask your tax office

Windfall shares

If you bought shares in a government privatisation, indexation runs from the date you acquired the shares, even if you paid by instalments.

Any loyalty bonus shares count as if you bought them at their market value on the date of issue. If you chose to receive vouchers instead, the initial value of your original shares is reduced by the value of the vouchers.

Free shares from a building society demutualisation are treated as acquired at 'nil cost'. This means you have no initial value to deduct from your gain, and indexation allowance does not apply (although taper relief does).

There may also be some tax to pay on a cash windfall. However, if the account that entitled you to the cash or shares was a joint account, the gain is normally split between the two of you.

The tax treatment of free shares from other demutualisations, for example, a life insurance company, depends on the exact terms of the deal, so check with the company.

Incentives to invest

Some shares qualify for favourable tax treatment:

- there is no capital gains tax on disposals of investments in a Pep, Isa, Venture Capital Trust and some shares in an Enterprise Investment Scheme
- you can put off paying some or all of your capital gains tax on the disposal of any asset if you reinvest in an Enterprise Investment Scheme or a Venture Capital Trust
- if you have an asset (including some types of shares) which has become 'of negligible value', you may be able to claim a loss even if you don't dispose of it. See Inland Revenue helpsheet IR286
- shares in an unlisted trading company, or a company for which you work, may qualify for increased taper relief as a 'business asset'.

CGT AND BUSINESS

If you are replacing some types of assets (including property) used in your trading business, 'roll-over relief' allows you to put off paying any capital gains tax.

If you are selling all or part of a trading business, you get the higher business rate of taper relief described on p48. You may also qualify for retirement relief if you are aged 50 or over or retiring through ill-health. However, this relief is being abolished for disposals after 5 April 2003.

Retirement relief may also apply if you sell shares in a trading company where you are a full-time director or employee and ▶

CAPITAL GAINS CALCULATOR

1 Work out your gain or loss on each asset

First, work from left to right to work out the gain (or loss) on any assets that aren't tax free. If you disposed of more than one asset in the 2001-2002 tax year, work through these three sections for each asset (copy this page and write in a description of the asset under 'Unindexed gain or loss'). This will give you a record to back up your tax return if you make a taxable gain. Also keep a record if you make a loss, as the loss can be used to reduce gains in future.

UNINDEXED GAIN OR LOSS

Description of asset _____

Final value _____ a

Initial cost _____

Allowable expense _____

Allowable expense _____

Unindexed gain _____ b

or Allowable loss or _____ c

INDEXED GAIN (ifowned before 1 Apr 1998)

Indexation factor

				aa
	x		=	
	x		=	
	x		=	
				bb

Indexed gain

TAPER RELIEF

Date asset disposed of _____

Date asset acquired _____

Number of complete years of ownership since 5 April 1998 (ie three years if acquired before 6 April 1998 and sold in 2001-2002) _____

Add one extra year if non-business asset owned before 17 March 1998 _____

Total qualifying years _____

Percentage of gain chargeable _____ % t

Enter the final value of the asset at **a** and deduct its initial value and any allowable expenses. If you incurred costs in the same month, you can add them together before entering them, but you need to enter costs incurred at different times separately.

- **If the result is a plus figure**, enter it at **b**. If you acquired the asset before 1 April 1998, go to **Indexed gain**. Otherwise, go straight to **Taper relief**
- **If result is a minus figure**, enter it at **c** and claim loss with Revenue (indexation and taper relief don't apply). Move on to your next disposal.

First, copy **a** to **aa**. Next, go to the indexation table on p52 and find the indexation factor for the months in which you acquired the asset and incurred each cost. Multiply the initial cost and any expenses (in the left-hand column) by the relevant factor and enter the indexed figures in the right-hand column. Deduct each indexed cost in the right-hand column from **aa**.

- **If the result is a plus figure**, enter it at **bb** and go to **Taper relief**
- **If result is a minus figure**, enter zero at **bb** (indexation cannot turn a gain into a loss). Ignore **Taper relief** and move on to your next disposal.

Work out the number of complete years between 5 April 1998 and the date of disposal and enter in the top box. If the asset is a non-business asset which you owned on 17 March 1998, add an extra year. The result is the total of your qualifying years. Go to the taper relief table on p48, find the appropriate percentage of gain chargeable and enter at **t**.

Now repeat the above steps for the next asset disposed of in 2001-2002. Once you have completed these steps for each asset, go to step 2a, below, to work out your overall gains.

2a Your overall gains for 2001–2002

The full capital gains tax calculations can be very complex, but don't worry – you may not need them. First, try this 'quick check' to see whether you need the full calculation.

Add up all your gains (**bb** if it's an indexed gain, otherwise **b**) and enter at **B**. — Total gains _____ B

Add up all your losses (from **c**, above) and enter at **C**. — - Total losses _____ C

Deduct **C** from **B** and enter at **D**. This is your total gain for the year.
- If **D** is under £7,500, you have no taxable gains – you can stop here.
- If **D** is a minus figure, you have a net loss to carry forward to future years.

= Gains/losses for year _____ D

Now enter any unused losses from earlier years. You only need to deduct enough to reduce your gains to the level of the tax-free slice, so at **E** enter **D** minus £7,500, or your unused losses if less. — - Unused losses from earlier years _____ E

Deduct **E** from **D** and enter at **F**. This is your gains after losses. If **F** is under £7,500, you have no taxable gains – you can stop here. — = Gains after losses _____ F

- If the same rate of taper relief applies to all your gains (ie **t**, above, is the same for all your disposals), multiply **F** by the relevant percentage and go straight to **step 3**.
- Otherwise, leave **G** blank and go to **step 2b** first.

x _____ % t

= _____ G

2b Deducting taper relief (more than one taper rate)

You only need **step 2b** if you made several disposals with different rates of taper relief. If not, go straight to **step 3**. Carry figures **C** and **E** across from **2a** and enter in the relevant boxes on the left-hand side.

Row T Copy the taper rates which applied at **t** in **step 1** (for different assets) to the top row. Enter the highest percentage (eg 100 per cent) in **T1**, the next highest rate (eg 90 per cent) in **T2**, and so on. Draw in another column if necessary.

Row B Enter at **B1** the amount of gains with the highest percentage chargeable. Gains with the next highest percentage go in **B2**, and so on for **B3**.

If you have losses from this year or earlier years, go to **row C**, otherwise, go straight to **row F**.

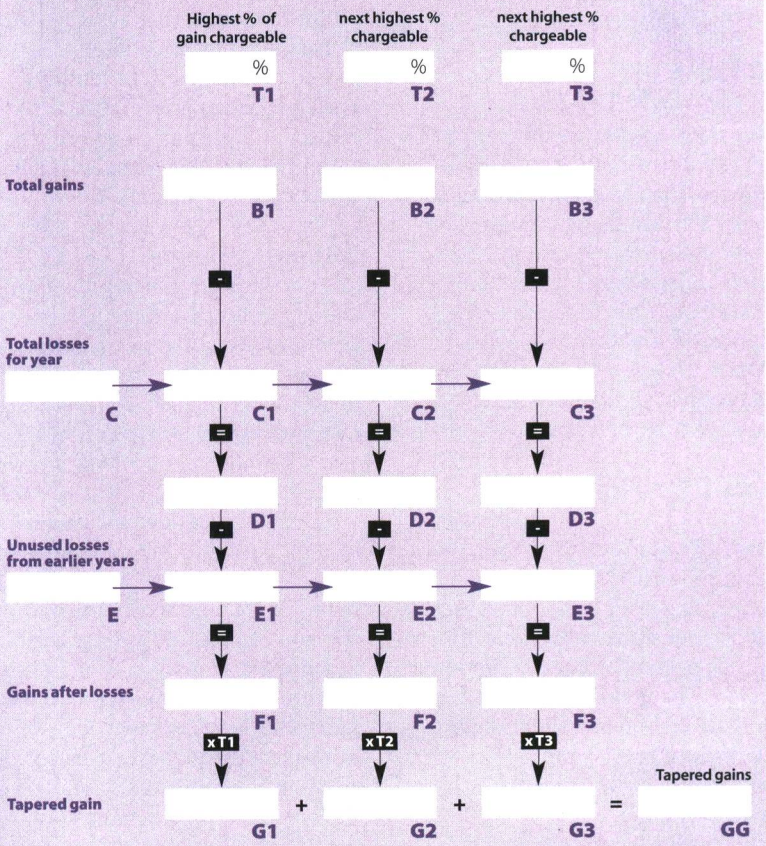
Row C It saves most tax to set off your losses first against those gains with the highest taper rate. So allocate your 2001-2002 losses working from left to right. At **C1**, enter **C** or box **B1** if less. At **C2**, enter **C** minus **C1**, or **B2** if less, and so on.

Row D Working down the columns, deduct losses from gains (eg enter **B1** minus **C1** in **D1**).

Row E Next allocate any unused losses from earlier years, but only enough to reduce gains to £7,500. At **E1** enter **E**, or **D1** if less. In **E2**, enter **E** minus **E1**, or **D2** if less, and so on.

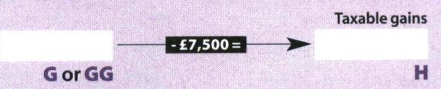
Row F Working down the columns, deduct losses from gains so far (eg **D1** minus **E1** in **F1**). If you had no losses, **F1** equals **B1**, and so on.

Row G Multiply your gains in **row F** by the relevant percentage chargeable and enter in **row G** (ie **F1** x **T1** goes in **G1**, **F2** x **T2** in **G2**, and so on). Add **G1**, **G2** and **G3** and enter in box **GG**.

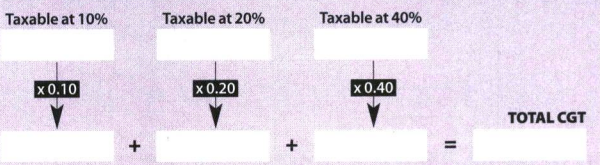


3 Amount of capital gains tax

Deduct the tax-free slice (£7,500) from your total tapered gains (either **G** from **step 2a** or **GG** from **step 2b**). The result is your taxable gain.



Taxable gains are taxed as if they were the final slice of your income. This means that your taxable gains are added to your taxable income and taxed at 10 per cent on amounts below the threshold for starting-rate tax (£1,880), 20 per cent on amounts below the basic-rate threshold (£29,400) and at 40 per cent above that limit.



EXAMPLE

Bill sold his holiday home in May 2001 for £85,000 (**a**). It cost £30,000 in May 1983. He spent £6,000 on an extension in June 1985. He subtracts these costs from the proceeds, to get an unindexed gain of £49,000 at **b**.

The home was owned before April 1998, so Bill moves to the middle section of **step 1**. He multiplies the purchase price by the indexation factor for May 1983 (1.921) to get an indexed cost of £57,630. The indexed cost of the extension is £10,224, so his total indexed gain at **bb** is £85,000 - £57,630 - £10,224 = £17,146. Bill has three qualifying years of ownership, plus an extra year because the house is a non-business asset owned before 1998. Only 90 per cent of the gain is chargeable – ie £17,146 x 90% = £15,431.

In 2001-2002 Bill also sold some shares for a gain of £5,000, with no taper relief (100 per cent of the gain is taxable), and some other shares for a £4,000 loss. **Step 2a** shows total gains of £22,146, minus losses of £4,000 = £18,146 at **F**. He has no losses from earlier years. Because different taper rates apply, Bill goes to **step 2b**, entering 100 in **T1** and £5,000 at **B1**, 90 in **T2** and £17,146 in **B2**. He enters his £4,000 losses at **C1**, leaving £1,000 at **F1**. **F2** is £17,146.

The whole £1,000 in **F1** is taxable, but only 90 per cent of the £17,146 in **F2**, ie £15,431. **GG** is £16,431. After the tax-free slice, this leaves £16,431 - £7,500 = £8,931 taxable. ▶

exercise at least 5 per cent of the voting rights.

ASSETS OWNED ON 31 MARCH 1982

For these assets, the initial value is normally the market value on 31 March 1982, and not the original cost. You also usually ignore any expenses before 31 March 1982. Indexation applies to the March 1982 value and to expenses incurred after that. For more information, see Inland Revenue helpsheet IR280 *Rebasing assets held at 31 March 1982*.

CGT ON YOUR HOME

If you've lived in the whole of your only or main home since you acquired it, CGT won't usually apply when you come to sell unless:

- you converted your home into a number of self-contained flats and sold them or built a second home in your garden and then sold it
- you use part of your home exclusively for business, or you let part of it
- you were away from your home for more than three years in total
- the home is one of a series that you bought in order to make money
- you were away for less than three years but didn't use it as your main home at some stage before and after.

Absences in the last three years before disposal are usually exempt, as are some first-year absences and those that are work related.

You may not get full exemption for your garden if, including the house, it's over half a hectare. See Inland Revenue helpsheet IR283 *Private residence relief*.

Letting your home

You don't lose any exemption if you are letting property through the rent-a-room scheme, or if you have a single lodger who shares your living rooms and eats with you. Otherwise, part of any gain when you sell property you let out may be liable for tax.

The gain is first divided into an exempt part and a non-exempt part, in line with how much of your home you let and the length of time you let it. Then, any lettings relief is deducted. The relief is the same amount as the exempt gain, or £40,000 if less. However, it is not available if the let part has been altered to be fully self-contained.

Note that property you let out doesn't qualify as a business asset for taper relief unless it counts as furnished holiday lettings or is let to a qualifying company and used for a trade.

More than one home

If you own more than one home, you may be able to choose which to treat as your tax-free main one. Preferably choose the one on which you think you'll make the largest gain – it doesn't have to be the one where you live most of the time. You must tell your tax office of the choice within two years of owning two homes. You can change your choice and specify the date the change should take effect, as long as this isn't more than two years before the date you notify your tax office of the change.

MORE HELP

Inland Revenue booklets

CGT1 Capital gains tax: an introduction

IR87 Letting and your home

Inland Revenue helpsheets

IR279 Taper relief

IR280 Rebasing – assets held at 31 March 1982

IR283 Private residence relief

IR284 Shares and capital gains tax

IR285 Share reorganisations and takeovers

IR286 Negligible value claims for shares

IR287 Employee share schemes

IR289 Retirement relief and CGT

IR297 Enterprise Investment Scheme and CGT

IR298 Venture Capital Trusts and CGT

CGT AND THE FAMILY

Whether or not any money changes hands, transfers of assets between a husband and wife are not taxable at the time (unless they are separated). When the asset is finally disposed of, the tax on it is worked out as if the recipient had owned the asset the whole time.

Note that if you dispose of an asset to another 'connected person', such as a close relative, a company you control or trust you have set up, you are counted as having sold it for its full market value. And if you make a loss on a disposal to a connected person, you can set that loss off only against a gain from another disposal you make to that person. So if you sell shares at a loss to your son or daughter, for example, that loss cannot be used to reduce your overall gains for the year.

INDEXATION FACTS

Imagine you paid £1,000 for a painting in May 1985 and sold it in May 2001. The indexed cost is £1,000 x 1.708 (factor for May 1985), which gives £1,708. You are liable to tax only on the difference between the selling price and £1,708.

Month	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Jan		1.968	1.872	1.783	1.689	1.626	1.574	1.465	1.361	1.249	1.199	1.179	1.151	1.114	1.083	1.053	1.019
Feb		1.960	1.865	1.769	1.683	1.620	1.568	1.454	1.353	1.242	1.193	1.171	1.144	1.107	1.078	1.049	1.014
Mar	2.047	1.956	1.859	1.752	1.681	1.616	1.562	1.448	1.339	1.237	1.189	1.167	1.141	1.102	1.073	1.046	1.011
Apr	2.006	1.929	1.834	1.716	1.665	1.597	1.537	1.423	1.300	1.222	1.171	1.156	1.128	1.091	1.066	1.040	
May	1.992	1.921	1.828	1.708	1.662	1.596	1.531	1.414	1.288	1.218	1.167	1.152	1.124	1.087	1.063	1.036	
June	1.987	1.917	1.823	1.704	1.663	1.596	1.525	1.409	1.283	1.213	1.167	1.153	1.124	1.085	1.063	1.032	
July	1.986	1.906	1.825	1.707	1.667	1.597	1.524	1.408	1.282	1.215	1.171	1.156	1.129	1.091	1.067	1.032	
Aug	1.985	1.898	1.808	1.703	1.662	1.593	1.507	1.404	1.269	1.213	1.171	1.151	1.124	1.085	1.062	1.026	
Sept	1.987	1.889	1.804	1.704	1.654	1.588	1.500	1.395	1.258	1.208	1.166	1.146	1.121	1.080	1.057	1.021	
Oct	1.977	1.883	1.793	1.701	1.652	1.580	1.485	1.384	1.248	1.204	1.162	1.147	1.120	1.085	1.057	1.019	
Nov	1.967	1.876	1.788	1.695	1.638	1.573	1.478	1.372	1.251	1.199	1.164	1.148	1.119	1.085	1.057	1.019	
Dec	1.971	1.871	1.789	1.693	1.632	1.574	1.474	1.369	1.252	1.198	1.168	1.146	1.114	1.079	1.053	1.016	

Saving for your retirement

The pensions world has just been through the biggest shake-up it's had in years, with the introduction of stakeholder pensions last April, and the State Second Pension in April 2002.

The changes to pensions are mostly good news for the consumer, with high charges becoming a thing of the past. They have also led to a greater reliance on private pensions for middle and higher earners. Generally, private pension plans remain a tax-efficient way to save for retirement. You get tax relief on your contributions, and your money grows largely tax free. Many plans let you take part of the proceeds as a tax-free lump sum. In this chapter we give a rundown of both state and private pensions as, in retirement, you may get pensions from many different sources.

BASIC STATE PENSION

If you've paid enough National Insurance (NI) contributions, you're entitled to the full basic state pension, which is £75.50 a week for single pensioners (or £118.90 a week for couples) from April 2002. Men can claim it when they reach 65, and women retiring now can claim it from age 60. The retirement age for women is going up in stages and will be 65 for women born after 5 March 1955 (see table right). You can defer taking this pension for up to five years, in which case your eventual pension is increased by 7.5 per cent for each year it's put off.

Married women's state pension income counts as their own for tax purposes and they can set their tax allowances against it. However, any adult dependency pension (paid to a man drawing a state pension whose wife doesn't qualify for a state pension in her own right) counts as the recipient's.

SERPS

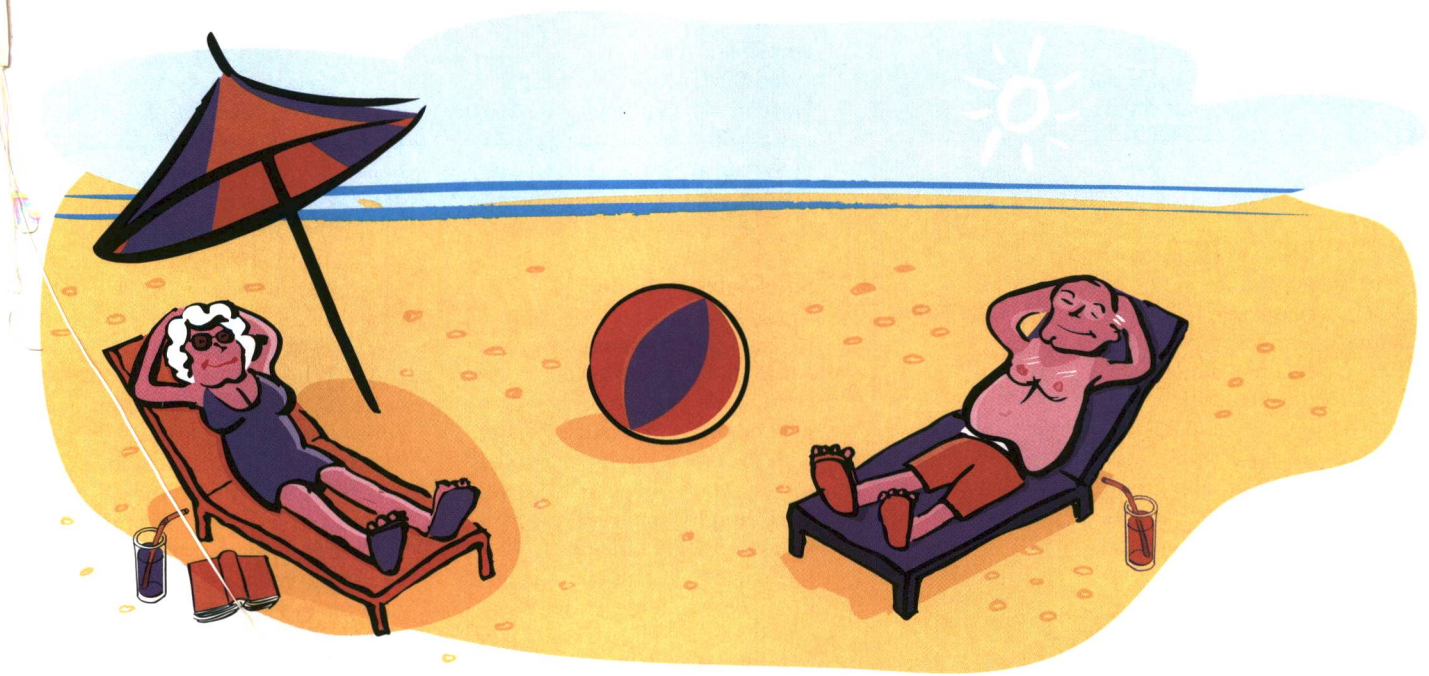
The state earnings related pension scheme (Serps) is a pension available to employees to supplement the basic state pension. It is an earnings-related pension based on the average of a slice of your earnings during your working life, provided you've made full-rate NI contributions. If you've contributed only part of the time, you'll get a lower Serps pension. Most people with an occupational scheme will not be eligible for Serps as their scheme will have 'contracted-out' of Serps. From April 2002, Serps is being replaced by a new state second pension. However, this won't affect any Serps entitlement you've built up.

S2P

The state second pension (S2P) like Serps, supplements the basic pension for employees. It is currently earnings related like ▶

EQUALISATION OF RETIREMENT AGE FOR WOMEN

Date of birth	Retirement age
6 April 1950	60 years 1 month
5 May 1950	60 years 1 month
6 May 1950	60 years 2 months
6 October 1950	60 years 7 months
31 March 1951	61 years
10 December 1951	61 years 9 months
15 June 1952	62 years 3 months
30 November 1952	62 years 8 months
22 February 1953	62 years 11 months
1 August 1953	63 years 4 months
8 January 1954	63 years 10 months
19 July 1954	64 years 4 months
25 September 1954	64 years 6 months
5 March 1955	64 years 11 months
6 March 1955	65 years



Serps, and gives a pension based on your earnings over your working life, but, unlike Serps, it gives proportionately more to low earners and carers. By not excluding carers (as Serps did), S2P gives people who have worked only part of the time a better deal. Again, most people with an occupational scheme will not be eligible for S2P as their schemes will have contracted out of it. For more detail on S2P, see 'All change for state pensions', *Which?*, March 2002, p48.

GRADUATED PENSION

This scheme existed between April 1961 and April 1975. You qualify if you were an employee during any part of this period and you paid NI contributions.

NON-CONTRIBUTORY RETIREMENT PENSION

This is a top-up pension for those aged 80 and over who either have no pension or whose pension is less than the normal state pension.

YOUR PRIVATE PENSION CHOICES

Currently there are two main options. If your employer offers a pension scheme, you can join that. If it doesn't (or if for some reason you don't want to join) or you're self-employed, you can start a personal pension – including a personal stakeholder scheme.

EMPLOYERS' SCHEMES

There are many different types of pension scheme that fall under the heading of employers' schemes. However, the information that follows relates to traditional employer pension schemes, known as occupational pension schemes. Employers can also offer group personal pension schemes and access to a stakeholder scheme.

It is also now possible for employers' money-purchase occupational pension schemes to opt in to the new tax regime brought about by the introduction of stakeholder pensions. Stakeholder schemes are covered by the rules related to personal pensions rather than the rules mentioned here.

Traditional occupational schemes

If an employer offers a traditional occupational pension scheme, it must contribute to it. Usually employees are also required to pay in – between 3 and 6 per cent of your salary is fairly typical. Some schemes don't require contributions from employees (these are known as non-contributory schemes). You can pay in up to 15 per cent of your annual earnings (including the taxable value of most fringe benefits, such as a company car) each year and still get tax relief. Employers' contributions don't count towards this limit and don't count as a taxable fringe benefit. You receive tax relief by your employer deducting contributions from your pay before working out your tax.

The pension you end up with depends on limits laid down by the Inland Revenue, the rules that apply to your particular scheme, and the type of scheme that your employer runs.

Although you receive tax relief on your contributions, you have to pay tax on your eventual pension. However, at retirement you can take part of the pension fund as a tax-free lump sum.

Final-salary schemes

These schemes pay a pension based on a proportion of your earnings at or near to your retirement. The amount you get depends on your length of service with the employer or the number of years you've been in the scheme. For example, Bob has worked 30 years for Bloggs Ltd and is about to retire. He's a member of the firm's final salary scheme, which pays one-sixtieth of his salary for every year he's served. If his final salary is £40,000, Bob will get 30/60 or one-half of his final salary every year as a pension – £20,000 a year.

Money-purchase schemes

The contributions you and your employer make are invested. When you retire, you use the money that has built up to buy a pension income. This is done by buying an annuity, which pays a regular income until you die.

Annuity rates vary, so the pension you get after retirement depends on the value of your pension fund and the annuity rates applicable at the time you take your pension. Annuity rates also vary between the pension companies offering annuities, so shop around to get the best deal.

Hybrid schemes

Hybrid schemes mix elements from both final-salary and money-purchase schemes. Check the scheme's rules to find out how it calculates your benefits.

Topping up your pension

To boost the pension you get from your employer, you can pay additional voluntary contributions (AVCs), either into the AVC scheme attached to your employer's pension scheme or by arranging a free-standing scheme (FSAVC) with an insurance company. However, FSAVCs have much higher charges than in-house AVCs and can be poor value. The financial services regulator, the Financial Services Authority (FSA), has instigated a review into mis-selling of certain FSAVCs and issued a factsheet (phone 0845 6061234 or see www.fsa.gov.uk).

AVC schemes (whether in-house or free standing) can only provide a pension. You can't take a tax-free lump sum from these schemes unless the scheme started before 8 April 1987. However, from April 2001, if you earn less than £30,000 a year and you are not a controlling director, instead of putting AVCs into your pension scheme or an FSAVC, you can pay up to £3,600

CONTRIBUTION LIMITS

The table shows the maximum percentage of 'net relevant earnings' (NREs) you can pay in to a retirement annuity contract (RAC) – middle column – or a personal pension plan (PPP) or stakeholder pension (SP) – right-hand column

If you're self-employed, net relevant earnings are broadly taxable profits. If you're employed, they are employment earnings that don't carry pension rights (so you can't count income from an employer whose pension scheme you are in). With stakeholder pensions and PPPs, you can take account of only the first £95,400 of your net relevant earnings (in 2001-2002).

Age at start of tax year	Plan taken out before July 1988 (RAC)	Plan taken out in or after July 1988 (PPP/SP)
up to 35	17.5%	17.5%
36 to 45	17.5%	20%
46 to 50	17.5%	25%
51 to 55	20%	30%
56 to 60	22.5%	35%
61 to 74	27.5%	40%
75 and over	nil	nil

There is also a 25 per cent limit on the proportion of a PPP or stakeholder fund that you can withdraw as a tax-free lump sum. With RACs, the maximum is instead three times the income from the remaining fund.

Note that there's a £150,000 limit for plans taken out on or after 17 March 1987.

(including tax relief) into a stakeholder scheme. Unlike most AVC schemes, you can take part of your stakeholder fund as a tax-free lump sum. The situation is different with added-years schemes (see below).

Added-years schemes

Available only through final-salary schemes, these AVCs give you the option to 'buy' extra years' service in your pension scheme. This automatically boosts all your benefits, including the tax-free lump sum. They are a good option if you won't have enough years' service to get the maximum entitlement at retirement.

Group personal pensions

These have the same rules as individual personal pension plans, but are run as a collective scheme with one pension provider. Your employer chooses the provider and pays premiums to it direct from your salary. Because the provider is collecting one sum for all employees' contributions direct from the employer, lower charges can be negotiated, so a personal pension taken out as a part of a group scheme will often have lower charges than a plan you buy direct yourself.

Despite this, some personal pensions, even as part of a group scheme, still have higher charges than the new stakeholder pensions.

Your employer does not have to offer access to a stakeholder scheme through your workplace if it runs an occupational scheme. Nor does it have to offer a stakeholder scheme if it has arranged a group personal pension that meets the following conditions:

- it must be available to all employees who should have access to a stakeholder pension scheme (except those under 18)
- the employer must contribute an amount equal to at least 3 per cent of the employee's basic pay to the personal pension
- the employer must deduct the employee's contributions direct from their pay and send them to the personal pension provider if the employee asks them to.

Stakeholder schemes offered by employers

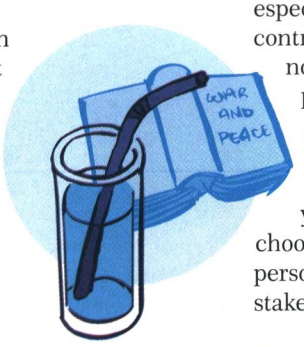
From October 2001 all employers with more than five employees must offer access to a stakeholder pension scheme, unless the employer already offers its staff an occupational pension scheme that all can join within a year of starting work with that employer, or already offers a group personal pension scheme that meets the conditions mentioned above. Group stakeholder pensions work in a similar way to group personal pension schemes, except the employer is not obliged to contribute to a stakeholder scheme, only to offer access to one.

Employers don't have to provide access to a stakeholder pension for any employee:

- who has worked for the employer for less than three months in a row
- who is a member of the employer's occupational pension scheme
- who cannot join the occupational scheme because its rules don't admit people if they are under 18 or they are within five years of the scheme's normal pension age
- who could have joined the employer's occupational scheme but chose not to
- whose earnings have not reached the National Insurance lower earnings limit for at least three months in a row, or
- who cannot join a stakeholder pension scheme because of Inland Revenue restrictions (for example, the employee lives abroad).

OTHER PENSION OPTIONS

Employers' schemes are nearly always the best sort of pension, especially if your employer is contributing. So you shouldn't normally take out a private pension if you are eligible to join an employer's scheme.



But if your employer doesn't run a scheme, or you're self-employed, you can choose to contribute to either a personal pension plan (PPP) or a stakeholder pension plan (SPP).

How do PPPs and SPPs work?

Personal stakeholder pensions are simply personal pensions that meet certain conditions, such as low charges and flexible contributions.

You pay contributions into these schemes over a period of time up to your chosen retirement date, at which time you use the fund to provide you with an income. You can take part of the fund as a tax-free lump sum. ▶

STAKEHOLDER PENSIONS

To qualify as a stakeholder pension, the plan must meet certain conditions:

- charges can be levied only as a percentage of the pension fund (so no separate policy fees, penalties and so on). This makes comparison with other products easier
- the maximum charge is 1 per cent of the fund a year (with personal pension plans, 1.25 per cent is common). This will include the cost of providing information and basic advice. Providers will be allowed to charge extra for detailed advice
- there can be no charges for transfers in or out of a stakeholder scheme
- it must generally accept transfers from other pension schemes
- the minimum contribution for regular or one-off payments must be no more than £20, and there must be no penalties for stopping and starting premiums.

A plan for all

The big change with stakeholders is that anyone, other than members of occupational schemes earning £30,000 or more or who are controlling directors, can pay into one, even if they have no taxable income. Until their introduction, only people with earnings could take out a pension plan and get tax relief on the premiums. (You can even pay into a stakeholder on behalf of your children – but be warned: they can't get their hands on the money until they're 50 so they may not thank you for it.)

Stakeholder or personal pension?

Stakeholder pensions have all the advantages of personal pensions, but none of the disadvantages. In addition, stakeholder pensions' charges are capped at 1 per cent of fund value, whereas personal pension charges are not. So even low charges on personal pensions could increase in the future.

As with personal pensions, you can draw your benefits at any time between age 50 and 75, and you can take a tax-free cash sum of up to 25 per cent of your fund. You can contribute to as many stakeholder plans as you want, provided you don't exceed your contribution limit. The age limit for starting a stakeholder pension is 75. The table on p55 shows the limits for stakeholders, personal pensions and old-style private pension plans – retirement annuity contracts (RACs). If you have no income, or a very low one, the limit is £3,600 gross for personal pensions and stakeholder pensions – but people with no earnings still can't contribute to RACs.

If you want a new pension, stakeholders will almost always be a better bet than old-style personal pensions.

How you get tax relief

The same tax regime applies whether you have a personal pension or a stakeholder pension.

You can contribute up to £3,600 a year gross (you pay £2,808) irrespective of earnings, even if you have no income at all. For contributions over £3,600, the existing personal pension levels (see the table, p55) will be used to work out the maximum you can put in. Also, contributions over £3,600 can continue to be made for up to five years after your earnings have ceased.

Contributions to either a stakeholder or personal pension are made net of basic-rate tax (whether you're self-employed, employed, or have no earnings). So with basic-rate tax at 22 per cent, you pay only £78 for a £100 contribution. If you're a higher-rate taxpayer, you claim the extra relief via the tax return. Even if you pay no tax or tax at the starting rate, you still get the tax relief, effectively adding a bonus to your savings.

You can still get relief on life insurance via stakeholder pensions and PPPs. For a policy started on or after 6 April 2001, premiums must not exceed 10 per cent of the contributions paid by the individual and the employer. For a policy started before that date, a limit of 5 per cent of your net relevant earnings continues to apply.

Carry back

You can ask for all or part of the amount you pay to your private pension (a personal pension, stakeholder or retirement annuity contract) to be treated for tax purposes as if you had paid it in the previous year (as long as you have enough unused relief in that year). So, for example, a contribution made in the current tax year can be treated as though it was made in the tax year ending April 2001. Relief is given at the tax rate applicable in the earlier year.

In the case of a personal pension or stakeholder scheme, you have until 31 January following the year to which you want to carry back the contribution to opt to use the carry-back rule. The option must be made before or at the time you pay the contribution. For example, if you want to carry back a payment to 2001-2002, you must pay it and make the option by 31 January 2003.

The rules for retirement annuity contracts (RACs) are different. To carry back a contribution to 2001-2002 it must be paid by 5 April 2003 and you have until 31 January 2004 to decide whether or not to carry it back. However, carry-back claims are only allowed once the tax for the earlier year has been calculated and paid. If you have an outstanding liability for that year, the relief you carry back is offset against it. If not, the Revenue repays the relief. Use Inland Revenue form PP43 to carry back contributions.

MORE HELP

Inland Revenue leaflets
IR78 Looking to the future
Inland Revenue helpsheet
IR330 Pension payments
FSA factsheet
Stakeholder pensions and decision trees
www.fsa.gov.uk or phone 0845 606 1234
DWP
Pensions information line phone 0845 7313233

You and your family

Whether you're married, cohabiting, divorced, widowed or have children, this chapter explains how the tax rules for families affect you.

Families come in all shapes and sizes, and so do the tax rules that affect them. Here are the details.

TAX AND MARRIAGE

Husbands and wives are taxed independently. This means each have their own personal allowance (the amount you can earn before you start paying tax). For the 2002-2003 tax year, this allowance is £4,615. If you don't use up all of your allowance, you can't transfer it to your husband or wife.

Up until April 2000, all married couples could claim the married couple's allowance. The relief was given as a deduction from other tax you owed. But since 6 April 2000, you can only claim this allowance if you, or your husband or wife, were born before 6 April 1935. For more information, see p41.

JOINT INCOME

If you and your spouse have investments in joint names (for example, shares), any income is initially treated as if it were received in equal shares: you each pay tax on half. If you own the investments in unequal shares, the income can be taxed the same way if you complete form 17 (from your tax office). If one spouse pays tax at the higher rate, and the other doesn't, or one spouse is a non-taxpayer, it makes sense to transfer income-paying investments to the person paying the least tax. This saves tax as long as the transfer is genuine (for example, the investment must be put into your spouse's name).

IF YOU ARE BEREAVED

In April 2001 the benefits you may be entitled to if your husband or wife dies were changed. The new benefits replace widow's allowance, widowed mother's allowance and widow's pension. However, if you were already receiving widowed mother's allowance or widow's pension before the new benefits came into effect, the changes won't affect you. You will carry on getting these weekly benefits for as long as you meet the old criteria. To claim the new benefits you must have been legally married – you won't be entitled to claim if you were divorced from or cohabiting with your late partner. Also, to be eligible, your late husband or wife must have either paid National Insurance contributions (your own don't count), or his or her death was caused by their job. The biggest change is that the new benefits are available to both widows and widowers. Previously, only women were eligible for bereavement benefits.

Bereavement payment

This is a tax-free payment of £2,000 (for the 2002-2003 tax year) paid to you as soon as you are widowed. However, it's only payable if your late husband or wife was not entitled to the state retirement pension when he or she died, or you were under state pension age when your husband or wife died. Those in receipt of state pension are not entitled to this payment.

Widowed parent's allowance

This is a taxable weekly benefit worth the same as the widowed mother's allowance. It includes:

- a basic allowance for you of £75.50 from April 2002
- an allowance of £11.35 from April 2002 for each of your dependent children, and
- additional pension (state earnings related pension) if you qualify.

You will be eligible if you have a child that qualifies for child benefit or you are a woman expecting your late husband's baby. If you are a widower whose wife died before the introduction of widowed parent's allowance, you can claim the new allowance, provided you meet the entitlement conditions.

Bereavement allowance

This is a taxable weekly benefit paid for 52 weeks after your husband or wife dies, to people ▶

aged 45 or over. This replaces widow's pension. You won't get bereavement allowance if you are entitled to widowed parent's allowance. The amount you get depends on your age.

Married couple's allowance

If your husband dies, and if you're still eligible for the married couple's allowance, it is given to your husband in the year of his death, even if you and your husband shared the allowance. You can claim any unused part after it has first been set against your husband's tax liability for the year of his death. If your wife dies, you can continue to receive the married couple's allowance for the whole of the tax year during which your wife dies. If part or all of the allowance had been allocated to your wife, you can have any unused part transferred to you.

OTHER TAXES

There's normally no capital gains tax to pay at the time a gift or transfer is made between spouses. This doesn't apply if you're divorced or separated (except in the tax year of separation), or to unmarried partners.

A husband and wife can give unlimited amounts of money or possessions to each other without being liable for inheritance tax unless the recipient's domicile (broadly, their permanent home) is outside the UK, when there is a £55,000 limit. Once divorced, this exemption is lost but there's still no inheritance tax to pay on:

- money paid as a divorce settlement
- maintenance payments to a former partner or children, including adopted and step-children, who are under 18 or in full-time education
- in some cases, money given to you following a change to an agreement you made on or before your divorce.

MORE HELP
Inland Revenue leaflets
IR45 Tax when someone dies
IR115 Tax and childcare

LIVING TOGETHER

If you live together as an unmarried couple, your income tax position is much the same as if you were

CLAIMING MISSED ALLOWANCES

If you don't claim an allowance, you have six tax years (before the current year) to reclaim it – until 6 April 2003 for allowances from 1996-1997. The amount of the allowance is shown in the table; where relief is restricted, the second column shows what the allowance is worth.

Unrestricted allowances

The full amount of personal and blind person's allowances is deducted from your income before working out tax.

Personal This is the amount you can earn each year before you pay tax. It's unlikely you won't receive it. But if you're 65 or older, you can claim a higher age-related amount. Note that you can't claim any of the basic personal allowance you may have missed. Nor can you transfer any surplus to your spouse.

Blind person's In England and Wales, you must be registered as blind on a local authority register to claim this allowance. There's no register in Scotland or Northern Ireland – you qualify if you can't perform any work for which eyesight is essential. If you are eligible for the allowance, but don't earn enough to use it up, you can transfer any surplus to your spouse.

Restricted allowances

These were abolished for most people from 6 April 2000. Relief was limited to a fixed percentage of the allowance, received by an adjustment to your PAYE code. From 1996-1997 until 1998-1999 relief was 15 per cent; it was cut to 10 per cent in 1999-2000. The table shows the amount of each allowance and what it was worth.

Married couple's This was given to married couples (only a proportion in the year they marry if the wedding is after 5 May). Higher amounts were (and still are) available to older people.

Additional personal You could claim this if you had a child in full-time education or under 16 (at the start of the tax year) who lived with you for all or part of the year, and you were single, cohabiting, widowed, divorced, or separated.

You could also claim this, in addition to married couple's allowance, if you were married and your husband or wife was incapacitated.

This double allowance used to be available only to men with wives who were incapacitated, but women with incapacitated husbands could also claim it from 6 April 1997.

Widow's bereavement You could claim this in the tax year of your husband's death and the following one, unless you remarried before the start of the tax year.

Maintenance relief This was available to some people who were paying enforceable maintenance payments.

Children's tax credit This allowance was introduced in 2001-2002.

Allowances	1996-1997 (£)		1997-1998 (£)		1998-1999 (£)		1999-2000 (£)		2000-2001 (£)		2001-2002 (£)	
	Amount	Worth	Amount	Worth	Amount	Worth	Amount	Worth	Amount	Worth	Amount	Worth
Unrestricted												
Personal	3,765		4,045		4,195		4,335		4,385		4,535	
Age-related personal (65 to 74)	4,910		5,220		5,410		5,720		5,790		5,990	
Higher age-related personal (75 or over)	5,090		5,400		5,600		5,980		6,050		6,260	
Blind person's	1,250		1,280		1,330		1,380		1,400		1,450	
Restricted												
Basic married couple's	1,790	269	1,830	275	1,900	285	1,970	197	2,000[1]	200	2,070[1]	207
Higher married couple's (65 to 74)	3,115	467	3,185	478	3,305	496	5,125	513	5,185[1]	518	5,365[1]	536
Higher married couple's (75 or over)	3,155	473	3,225	502	3,345	502	5,195	520	5,255	525	5,435	543
Additional personal	1,790	269	1,830	275	1,900	285	1,970	197				
Widow's bereavement	1,790	269	1,830	275	1,900	285	1,970	197	2,000[2]	200		
Maintenance relief	1,790	269	1,830	275	1,900	285	1,970	197	2,000[3]	200	2,070[3]	207
Children's tax credit											5,200	520

1 Available only if you or your husband or wife were born before 6 April 1935

2 Available only if you claimed widow's bereavement allowance in 1999-2000

3 Available only if you or your ex-spouse was born before 6 April 1935

married. However, there are some differences. You won't be entitled to the married couple's allowance (even if you or your partner were born before 6 April 1935), nor are you entitled to CGT and IHT concessions.

Also, if you are unmarried and your partner dies, you can't claim any of the bereavement benefits paid to widows or widowers, (see 'If you are bereaved', p57).

UNMARRIED WITH CHILDREN

Before 6 April 2000, unmarried parents living with a child could claim an allowance called the additional personal allowance. Like the married couple's allowance, this was given as a deduction from your tax bill, but it was abolished from 6 April 2000. However, the new children's tax credit that you can claim (see below) replaced this from April 2001.

If you were eligible for the additional personal allowance at any time from 6 April 1996 to 5 April 2000, but didn't claim it, you can do so now – see our table on missed allowances, opposite.

TAX AND CHILDREN

A new tax allowance, the children's tax credit (CTC), was introduced from 6 April 2001. It's available to all parents with one or more children under 16 living with them. Despite its name, it doesn't work like the working families tax credit (see 'Tax credits', p27). Instead, a percentage of the allowance (10 per cent) is given as a deduction against your tax bill in the same way as the married couple's and additional personal allowance. In 2001-2002 the allowance was £5,200, so the tax bill of eligible families was reduced by £520 (the level for 2002-2003 is due to be announced in the April Budget).

If neither parent is a higher-rate taxpayer, you can choose which parent claims the credit, or have it split between you, provided you do this before the beginning of the tax year. However, if one parent is a higher-rate taxpayer, the allowance must be claimed by them as the credit is gradually withdrawn at the rate of £1 for every £15 of income taxed at the higher rate. So, if one of you earned over £41,735 in 2001-2002, it's unlikely you would have received any CTC. From this April, CTC is doubled in the tax year of a child's birth.

To claim children's tax credit, you need to complete form CTC1 available from your tax office or from the special Inland Revenue helpline (0845 300 1036).

Childcare payments

If your employer provides a crèche that you're eligible to use, this benefit isn't taxable. However, if you receive childcare vouchers, the value of these is added to your salary and taxed as income. The benefit to receiving vouchers is that they aren't counted as income when working out how much National Insurance you pay.

SEPARATION AND DIVORCE

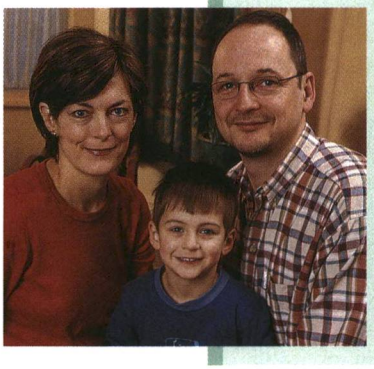
There is now no tax relief on maintenance payments unless you or your ex-partner were born before 6 April 1935. If you are still eligible to claim maintenance relief, you receive a reduction in your tax bill as you do with married couple's allowance or children's tax credit. The amount deducted is equivalent to 10 per cent of either the maintenance you pay or £2,070 (2001-2002's maintenance allowance), whichever is lower. Maintenance allowance is £2,110 for 2002-2003. The rules for receiving maintenance are also simpler. Payments you receive under a maintenance agreement are now treated as tax-free income, regardless of whether they're from an ex-spouse, parent or step-parent.

WIDOW'S BEREAVEMENT ALLOWANCE

This was a tax allowance given to widows in the year of their husband's death and for the year after that, provided they didn't remarry. However, this allowance was abolished in the 1999 Budget.

If your husband died between 6 April 1999 and 5 April 2000, you were entitled to claim the allowance for the 1999-2000 and 2000-2001 tax years. If you didn't claim, you still can – see the table on missed allowances, opposite.

A SECOND BABY COULD BRING BONUSES



A change announced in the 2001 Budget should benefit Lynn and Malcolm. The couple are expecting their second child this June. They're already eligible to claim the children's tax credit for their son Ben, but from April 2002, the allowance will be doubled for the first year of their second child's birth – so Lynn and Malcolm should win out when their new baby arrives.

Malcolm is a higher-rate taxpayer, so he has to claim the allowance, which is gradually taken away from higher earners. In 2001-2002, people earning over £33,935 had their allowance reduced, while people earning over £41,735 didn't benefit at all. Malcolm works freelance so he can't easily estimate his income for 2002-2003. However, he thinks it will be lower than £41,735. All being well, he and Lynn should get a baby bonus.

Helplines

- **National Council for One Parent Families** 08000 185 026
- **Citizens' Advice Bureaux** see phone book
- **Federation of Information and Advice Centres** 020 7489 1800
- **Inland Revenue children's tax credit helpline** 0845 300 1036
- **Inland Revenue working families tax credit helpline** 0845 609 5000

Gifts and bequests

Planning ahead can help reduce the tax you pay when you pass on money or property as a gift or legacy – to your family, for example.

There are two types of tax that you usually need to consider when you make a gift – capital gains tax and inheritance tax.

Capital gains tax (CGT)

There's no CGT on cash gifts, or on anything you leave when you die. But if you give away an asset, such as a painting, you may have to pay CGT if its value increased while you owned it (see p47).

Inheritance tax (IHT)

Most gifts that you make while you're alive currently escape IHT. But if you die within seven years of making the gift, the recipients could face a bill. The tax that's payable, and who pays it, depends on what the gift is, and whether you make it during your life, or via your will after your death.

TAX-FREE GIFTS

The following gifts are always free of both CGT and IHT whether they are made during your lifetime or as a bequest in your will when you die:

- gifts between a husband and wife who are both domiciled in the UK at the time of the gift. For CGT purposes, the couple must live together for some of the tax year
- gifts to UK-established charities
- gifts to national art galleries, universities, local authorities and other similar bodies
- gifts of UK land to registered housing associations
- broadly, gifts of shares in a company to a trust that holds over half the company's shares, that was set up for the employees' benefit, and over which the trustees have voting control.

IHT-EXEMPT GIFTS

The following gifts, which you might make during your lifetime, are always free of IHT. However, if the gift is an asset, rather than cash, there may be some CGT to pay:

- gifts to people getting married, with a maximum value of £5,000 from each parent of the couple, £2,500 from each grandparent, and £1,000 from anyone else
- gifts worth up to £250 a year to each recipient
- gifts up to any amount that are part of your normal expenditure (such as premiums on a life insurance policy for someone else's benefit), provided they don't reduce your standard of living
- gifts of reasonable amounts to support a dependent relative
- gifts for the education, training or maintenance of your children if they are still in full-time education or training, or aged 18 or below
- maintenance paid to ex-spouses and transfers of property as part of a divorce settlement
- gifts to political parties represented in Parliament. Such gifts can also be made on death and are then free of CGT as well as IHT.

Each tax year, annual gifts up to £3,000 not covered by the list above are free of inheritance tax. Spouses each have their own £3,000 limit. If you don't use up the limit, you can carry it forward one year only to the next tax year and give up to £6,000.

LIFETIME GIFTS AND IHT

Gifts that are taxable for IHT when you make them are mainly gifts to companies and to the trustees of certain types of trust where no specific beneficiary has a right to income. These are known as discretionary trusts.

Even then, IHT is due on the gift only if the sum of your taxable (also known as chargeable) gifts over the seven years up to the time of the latest gift (your running total) comes to more than the tax-free IHT allowance (£242,000 in the 2001-2002 tax year).

If IHT is payable on lifetime gifts, it is charged at half the rate charged at death (so currently at 20 per cent). If you die within seven years of making the gift, tax is reassessed at the then death rates (currently 40 per cent) and extra tax may be payable.

MORE HELP

Inland Revenue leaflets

IR45 What to do about tax when someone dies
IR65 Giving to charity
IR152 Trusts
IHT2 Inheritance tax on lifetime gifts
IHT3 Inheritance tax – an introduction
IHT15 Inheritance tax – how to calculate the liability

Inland Revenue helpsheets

IR282 Death, personal representatives and legatees
IR295 Relief for gifts and similar transactions

TAPER RELIEF

Time from gift to death	Reduction in tax payable on Pet (%)
0 to 3 years	nil
3 to 4 years	20
4 to 5 years	40
5 to 6 years	60
6 to 7 years	80

POTENTIALLY EXEMPT TRANSFERS

Most gifts or transfers made during your lifetime, other than those already mentioned, are treated as potentially exempt transfers (Pets). No IHT is payable when you make the gift, but if you die within seven years of making it, the gift is included in the IHT calculations.

On your death, all Pets and other taxable lifetime gifts you made in the previous seven years are treated as part of your estate and applied in chronological order to the tax-free IHT allowance. Although this means that often no IHT is paid on past gifts, it does mean that some or all of the tax-free slice is used up, leaving little or no relief for the rest of the estate. If tax does become payable on a Pet, it is levied at the rate applicable at death (currently 40 per cent). However, if a Pet does attract tax, it may be reduced depending on the

length of time from making the gift to death. This is called taper relief, as shown in the table, left. Taper relief applies only to the extra tax due on the Pet (see example below).

PAYING TAX

The giver pays any CGT on gifts made during their lifetime. Liability for IHT depends on when the gift is made. If it's taxable at the time the gift is made, either the giver or the recipient can pay the IHT. If the giver pays, the total gift is assumed to be the value of the gift plus the tax. If the giver fails to pay the tax, the Revenue may be able to recover it from the recipient. If tax becomes due because the giver has died within seven years of making the gift, it is charged initially to the person who received the gift. If they can't or won't pay, the giver's estate must pay the bill.

GIVING AWAY A BUSINESS

You may qualify for hold-over relief from CGT when you give away business assets, including certain unlisted shares in trading companies. This means there is no tax to pay at the time of the gift, and any increase in the value of the asset after it is given away will be taken into account only when the recipient sells on the assets. If retirement relief applies (see 'CGT and business', p49), this takes precedence. Most gifts of business assets qualify for business property relief from IHT at up to 100 per cent, provided that the business owned is not wholly or mainly an investment business. So, in most cases, no IHT (or a reduced amount) will be payable.

THE EFFECT OF TAPER RELIEF ON IHT

A man gives each of his five children a gift of £15,000 between 1994 and 1998 (£75,000 a year). He dies on 30 April 2001. This is how the gifts are treated for IHT on his death, assuming he's used his £3,000 gift exemption each year, and that no gifts qualified for the exemption for normal expenditure out of income.

Date of gift	Running total	Tax payable	Reason
25 Dec 1994	£75,000	nil	Gift within tax-free slice of £242,000
25 Dec 1995	£150,000	nil	Gift within tax-free slice of £242,000
25 Dec 1996	£225,000	nil	Gift within tax-free slice of £242,000
25 Dec 1997	£300,000	£18,560	£17,000 is within £242,000 tax-free slice. The remaining £58,000 is subject to IHT but the tax is reduced by 20 per cent (see the taper relief table, opposite)
25 Dec 1998	£375,000	£30,000	All the gift is subject to IHT with no reductions. The remaining estate is also subject to IHT at the full 40 per cent, as all the tax-free slice has been used up on Pets made within the seven years before death

TAX ON YOUR DEATH

There is no CGT on assets that you leave when you die, but your estate may have to pay IHT depending on how much you leave. To value your estate, add up:

- any gifts you made in the last seven years that are not exempt from IHT (ie Pets you have made and any chargeable lifetime gifts)
- your property (include any you own abroad), cash, savings and investments and life insurance paid to your estate
- income/property you are entitled to under the terms of some trusts
- any gift you still continue to benefit from (for example, a house you have given to your children which you continue to live in). This is known as a 'gift with reservation' and for IHT purposes it is as though the gift was never made.

After that, subtract:

- gifts in your will that are exempt from inheritance tax (to a surviving spouse, for example)
- your debts (such as a mortgage) and reasonable funeral expenses.

If the total value of your remaining estate is no more than the tax-free slice, there is no IHT liability. If it is valued above this, the excess will be taxed at 40 per cent on death.

Tax on bequests

You can specify in your will that a bequest is to 'bear its own tax' – this means that the person receiving the gift pays any tax due; otherwise, the estate has to pay the IHT. If it is a cash gift, the recipient receives the net sum.

MAKING A WILL

Every adult should make a will. If you don't make a will, according to the law you die 'intestate', and ▶

this can mean that the people you'd want to benefit from your death don't get a penny. Your estate is divided among your family according to strict rules.
In England and Wales the Administration of Estates Act 1925 applies. See the chart, right, to see how the rules work.

The rules for Northern Ireland are similar to those in England and Wales except where there is a surviving spouse and children. As with England and Wales, the surviving spouse gets the personal chattels plus the first £125,000 of the estate. However the spouse gets a varying proportion of the remainder depending on the number of children.

The rules for Scotland are very different from those for England and Wales, and have evolved from its separate legal tradition. In broad terms, the law provides first for the widow(er) through 'prior rights' to the family home, its furnishings and a cash sum. After this, there are the 'legal rights' of the widow(er) and any children. The remainder of the estate (if any) is taken by the nearest relatives.

Making a will is especially important for unmarried couples as the concept of a 'common-law' wife or husband is not recognised in the intestacy rules, and so the surviving partner has no automatic right of inheritance. There are rules for England and Wales allowing an unmarried partner to claim a share of your estate if you lived together for two years before death, but these don't apply in Scotland.

Making a will isn't just important for financial reasons. If you have children your will should state the people you want to act as their guardians, and any money they will receive for doing this.

If you make a will you can also decide who will be your executors – the people who administer your estate after your death. If you die intestate, your nearest relatives will usually be given this task, whether you would want this or not. Adult beneficiaries of a will or an intestacy can vary the provisions to make it more tax efficient. This is called a deed of variation and must be done within two years of the deceased's death. Note that all the beneficiaries of the will or intestacy that's being varied who would lose out as a result of the changes must agree to the change.

It is possible to use your will for tax planning. During the 2001-2002 tax year, each person could give up to £242,000 without paying IHT. Married couples together had an allowance of £484,000. However, unless a person's allowance is used during their lifetime, on their death, or by a deed of variation within two years of death, it will be lost, as it cannot be transferred to the surviving spouse.

By making some simple adjustments to your will, so that part of your estate passes to the next generation rather than wholly to your spouse, you will substantially reduce the IHT bill when both you and your spouse have died. In fact, you could end up paying no IHT at all.

INTESTACY RULES IN ENGLAND AND WALES

Where the deceased leaves	What happens to the estate
A spouse but no children	Surviving spouse gets 'personal chattels', the first £200,000 plus half the remaining estate. The rest goes to the deceased's parents. If none survives, to siblings (or their children[1]). If none survives, the spouse inherits the estate
A spouse and children	The spouse gets 'personal chattels', the first £125,000 plus a life interest on half the remainder (which passes on death to the children). The children[1] inherit the rest
No spouse but children	The estate is divided equally between the children[1]
No spouse or children	The estate goes to the deceased's parents. If neither parent is living it passes to relatives in the following order: • brothers/sisters (or their children[1] if the parent has died) • grandparents • uncles/aunts (or their children[1] if the parent has died)
No relatives	The estate goes to the Crown

1 Where the beneficiaries are minors, the assets would be held on statutory trusts until they reach 18

HOW TO REDUCE IHT

You can't avoid IHT by giving something away if you continue to benefit from it. For example, if you give away your house but continue to live in it, this is known as a gift with reservation and still counts as part of your estate. But you can take steps to reduce the amount of IHT payable when you die.

You can take out an insurance policy to cover any IHT liability – but if you do, make sure you put it into trust. Your insurance company can provide the necessary forms.

Start making gifts early: gifts to individuals made at least seven years before your death are free of tax (although there may be CGT to pay if you give away assets rather than cash). You can also use your gift allowances – some gifts made in your lifetime are tax free even if you die within seven years of making the gift.

Another point is that most couples own assets under a joint tenancy. This means that on the death of one partner, the asset passes automatically to the surviving owner, overriding what the will may say. This can ruin careful IHT planning. It's possible to hold assets under a tenancy in common, where each person owns part of the asset separately and can decide who their portion is left to. You can see a solicitor if you want to change this, but bear in mind that you don't want to endanger the right of the surviving spouse to live in the family home after your death.

Check your income tax

Get your tax return in by the end of September and the tax office will work out your tax. But check the figures – the Revenue does make the odd mistake.

The tax calculation guide sent with your tax return allows you to work out your tax bill. But if your tax affairs are quite straightforward, our calculator (p64) quickly gives your income tax bill for 2001-2002.

USE THE TAX BANDS

Different rates of tax now apply to different types of income. This means that the order in which you use up your tax allowances and slot your income into the basic-rate tax band and £1,880 starting-rate band can make a difference. The calculator takes this into account.

The current rules make working out your tax complicated if you have income of lots of different types. To keep our calculator simple, it doesn't take account of:

- taxable gains from life insurance
- taxable lump sums from employers
- charitable payments under a deed of covenant or Gift Aid scheme if you pay little or no tax
- double taxation relief on income from abroad (otherwise foreign income is treated largely as if it were UK income of the same type)
- student loan repayments collected through the tax system
- any over- or underpayments of tax from a previous tax year.

If anything in this list applies to you, use the Inland Revenue's full tax calculation guide instead.

WHAT TO ENTER

The calculator first works out the tax due on your gross income minus gross tax-allowable deductions. It then takes account of other tax relief due and tax already paid. Dividends and most savings income are usually received net (after deduction of tax). And you make some tax-allowable payments net by first deducting basic-rate relief. To find the gross amount, either add together your net amount plus the tax, or divide the net amount by 0.8 for savings, 0.9 for dividends, and 0.78 for charitable donations and net pension payments. If any calculation results in a negative figure, enter zero (except in the last box). Check the letters and boxes carefully.

MORE HELP

If you're affected by any special rules or types of income not covered by this calculator, you need the Inland Revenue's full tax calculation guide. If you need a copy, call the Inland Revenue orderline on 0845 9000 404.

ALLOWANCES

Only personal and blind person's allowance (step 2) give full tax relief. Married couple's allowance and maintenance deduction are now available only if you (or your husband or wife) were born before 6 April 1935. Instead, children's tax credit has been introduced. The full credit is worth £520 in 2001-2002 but this is reduced if you share the credit with a partner, or if you are a higher-rate taxpayer. Widow's bereavement allowance has been abolished.

Any unused married couple's allowance, children's tax credit and blind person's allowance can be transferred between spouses. Include any transferred amount with your own allowances.

TAX-FREE INCOME

Don't include in the calculator any tax-free income such as:

- savings or investment income from Isas, Peps, Tessas or Friendly Society tax-exempt plans
- National Savings Certificate interest; Premium Bond prizes; the first £70 of interest from the National Savings Ordinary Account
- most proceeds from qualifying life insurance policies; interest on SAYE accounts
- education grants and scholarships
- some damages for personal injury
- interest on tax rebates or on delayed compensation for injury or death
- statutory redundancy pay and (within limits, see p21) some payments from employers
- housing benefit, council tax or rent rebates and home improvement grants
- adoption allowances and some social security benefits
- maintenance and alimony
- income from family income benefit life insurance policies
- some insurance benefits paid because you are sick, disabled or unemployed, including income from most permanent health policies
- betting winnings and lottery prizes.

INCOME TAX CALCULATOR

Enter the gross (before-tax) amount of your income for 2001-2002 in the right-hand boxes. Under 'Tax paid' enter any tax deducted through PAYE, plus any payments on account made on 31 January 2002 and (if relevant) 31 July 2002. Do not include any payments made to cover tax outstanding from earlier years.

1 Enter your non-savings income

	TAX PAID	INCOME Gross
Income from employment Include your basic salary or wage, commission, bonuses, tips, holiday pay, taxable sick and maternity pay, taxable income from a profit-sharing scheme, and the taxable value of fringe benefits. Deduct any contributions to your employer's pension scheme, charitable payments made through a payroll-giving scheme and anything spent on allowable expenses that isn't reimbursed.		
Pensions and social security benefits Enter only the taxable amount (whoever pays the benefit should tell you this). For pensions from abroad, this is 90 per cent of the amount due.		
Taxable profits from self-employment or a partnership and freelance earnings (after loss relief). See p28 for information on working out your taxable profits.		
Income from land or property Enter your profits, after deducting expenses. If you let rooms under the rent-a-room scheme, don't enter any tax-free amount of rental income.		
Other taxable non-savings income For example, non-savings income from trusts, settlements or the estates of people who have died.		
Add up all the gross income and enter it at A		A

2 Deduct your tax-allowable deductions and full-relief allowances

Personal allowance If you were born after 5 April 1937, enter £4,535. If you were born on or before that date, you may get a higher allowance – see p43 for how to work this out.		
Blind person's allowance If you were entitled to this allowance, enter £1,450 here. If your spouse can claim the allowance but doesn't use it in full, enter any unused amount here and put in a claim to transfer it. See p13.	+	
Pension contributions paid gross Enter payments to a retirement annuity contract, including any life insurance bought through the plan but excluding payments 'carried back' to a previous tax year. Don't include any other private pensions (these are all now paid after tax relief).	+	
Other full-relief deductions For example, interest on a loan to buy into a company or partnership; relief on gifts of qualifying investments to charity.	+	
Add up all the allowances and gross deductions and enter at B	=	B
If **A** is more than **B**, deduct **B** from **A** and enter at **C**. This is the taxable amount of your non-savings income.		C
If **B** is more than **A**, deduct **A** from **B** and enter at **D**. This is the amount of your allowances and deductions not needed to reduce your non-savings income to zero.		D

3 Find the taxable amount of your savings income and any tax deducted at source

	Net		Tax deducted		Gross
Enter the amount of any taxable interest received from banks, building societies, National Savings and gilts (British Government stocks) Enter the amount received and any tax deducted, and add the two together to get gross income.		+		=	E
If **E** is more than **D**, deduct **D** from **E** and enter at **F**. This is the taxable amount of your savings income.					F
If **D** is more than **E**, deduct **E** from **D** and enter at **G**. This is the amount of your remaining allowances and deductions not needed to reduce your non-savings income to zero.					G
Add up tax paid and tax deducted and enter the total in the box, right			Tax already paid		

4 Find the taxable amount of dividend income and any tax already paid/deducted

	Dividend		Tax credit		Gross
Enter any dividend or distribution received from shares, unit trusts or Oeics Enter the amount received, and any tax deducted (the tax credit), and add the two together to get gross income.		+		=	H
If **H** is more than **G**, deduct **G** from **H** and enter at **J**. Otherwise enter zero. This is your taxable dividend income.					J

5 Adjust your basic-rate tax band by adding tax-allowable payments made net

	Amount paid		Tax relief		Gross
Pension contributions paid net If you paid into a personal pension or stakeholder pension, or free-standing additional voluntary contributions, enter the amount paid, tax relief already received, and add them together to get the gross amount. Don't include payments 'carried back' to a previous tax year.		+		=	
					+
Charitable giving If you made donations under a deed of covenant or the Gift Aid scheme, enter the amount paid, the basic-rate relief you deducted before making the payment, and add together to get the gross amount. Note that if you made charitable donations, and the tax relief is more than (or close to) the tax due at the end of step 7, the tax relief may be clawed back. The calculator does not cover this.		+		=	
					+ £27,520
Add the two boxes in the right-hand column to the amount of the basic-rate band (£27,520) This gives you any higher-rate relief due on these payments. Copy the result to the starred box in step 6.					*

6 Allocate your income to tax bands

Your non-savings income Enter **C** from **step 2** and * from **step 5.**

- At **K** enter either **C** or £1,880, whichever is lower.
- Deduct **K** from **C** to find **L**.
- At **M** enter either **L** or the adjusted basic-rate band, if lower.
- Deduct **M** from **L** and enter the result at **N**.

Now, working down the columns, deduct **K** from **£1,880** and enter the result at **O**: deduct **M** from the adjusted basic-rate band and enter the result at **P**. This gives you the amount of your starting- and basic-rate bands unused so far

Your savings income Enter **F** from **step 3**.

- At **Q** enter **O**, or **F** if lower.
- Deduct **Q** from **F** to find **R**.
- At **S** enter **P**, or **R** if lower.
- Deduct **S** from **R** and enter the result at **T**.

Working down the columns again, find your remaining tax bands. Enter **O** minus **Q** at **U**, and **P** minus **S** at **V**

Your dividend income Enter **J** from **step 4**. At **W** enter **U**, or **J** if lower. Deduct **W** from **J** to find **X** (enter zero if negative). At **Y** enter **V** or **X** if lower. Deduct **Y** from **X** to find **Z** (enter zero if negative).

	Starting-rate band			Adjusted basic-rate band		Higher-rate band All income over £29,400
	£1,880					
				*		
C	- K	=	L	- M	=	N
	O			P		
F	- Q	=	R	- S	=	T
	U			V		
J	- W	=	X	- Y	=	Z

7 Work out the tax

Add up **K+Q+W+Y**. This is your income within the starting-rate band, plus dividends within the basic-rate tax band. Multiply by 10 per cent.		x 0.10 =	
Enter **S** from **step 6** (your savings income within the basic-rate band) and multiply by 20 per cent.	S	x 0.20 =	
Enter **M** from **step 6** (your non-savings income within the basic-rate band) and multiply by 22 per cent.	M	x 0.22 =	
Enter **Z** from **step 6.** This is your dividend income liable to higher-rate tax). Multiply by 32.5 per cent.	Z	x 0.325 =	
Add up **N+T** from **step 6.** This is your non-dividend income liable to higher-rate tax. Multiply by 40 per cent.		x 0.40 =	
Add up all the tax due (the five boxes in the right-hand column)			

8 Deduct extra tax relief

Dividend tax credits Enter **J** from **step 4** and multiply it by 10 per cent.	J	x 0.10 =	
Enterprise Investment Scheme/Venture Capital Trusts Enter amount paid which qualifies for tax relief and multiply by 20 per cent.		x 0.20 =	
Married couple's allowance, maintenance deduction If you (or your husband/wife) were born before 6 April 1935, enter the amount you have claimed and multiply by 10 per cent.		x 0.10 =	
Children's tax credit Enter amount claimed, reduced by £2 for every £3 of income taxed at the higher rate (two thirds of **N+T+Z**). If your partner claimed the allowance but didn't use it in full, enter any unused amount here and put in a claim to transfer it. See p13 for more information. Multiply by 10 per cent.		x 0.10 =	
Calculate your income tax Deduct your tax relief from the tax due at the end of **step 7** (enter zero if this produces a minus figure). The result is your income tax bill.		=	

9 Add class 4 national insurance

Enter Class 4 National Insurance on your taxable business profits This is 7 per cent of profits between £4,535 and £29,900. If your profits are over £29,900, enter £1,775. If they are below £4,535, enter zero. Add to tax due at the end of **step 8** and enter the total, right.	+	
	=	

10 Work out your tax bill

		Tax already paid
Enter your tax already paid from **step 3**. Then deduct from the tax due at the end of **step 9**.	-	
The result is your tax bill or, if a minus figure, your tax overpaid. (Note that you may need to make adjustments if you have already had a tax refund during the year.)	=	

Common problems

Q I've just sold my house. Will I have to pay capital gains tax on the sale?

A You don't normally pay capital gains tax on the sale of your main residence, but there are circumstances where you might have to pay. For example, if you're self-employed and use part of your house exclusively for business, then you might have to pay capital gains tax on that part. For more details, see p52 of this guide and Revenue helpsheet IR283 *Private residence relief*.

Q I've just become self-employed. What do I do about tax and National Insurance?

A You must notify your tax office of your change in situation by the October following the end of the tax year you became self-employed. See p8 for information on how to find your tax office. Also, ring the Revenue's helpline (08459 154515) to get a copy of the Inland Revenue booklet P/SE/1 *Starting your own business*. This has all the information you need, plus a form covering tax and National Insurance, which you must complete and return to your tax office. Remember, you must decide an accounting year-end and start to keep records of your business expenditure and income as soon as you start your business.

Q I've just changed jobs and am paying 'emergency rate' tax. What does this mean?

A If you can't give your new employer a P45 from your previous job, then you have to fill in a P46 as you did for your first job. Until things get sorted out, your employer may operate the emergency code on a 'week one' or 'month one' basis. In practice, this works as though it's the start of the tax year, and consequently no account is taken of any free-of-tax pay due from the beginning of the tax year to the time you started working. You may pay too much tax for a while, but when the Revenue allocates your correct code, your employer will refund any overpayment.

Q I'm a full-time student working during my vacation – do I pay tax?

A You only need to pay tax if you estimate that your total income for the tax year will be more than your personal allowance. If it won't be more, ask your employer for form P38(S). Return your completed form to your employer so that your wages can be paid without deduction of tax.

Q I'm over 65. How much can I earn before paying tax?

A The over-65s get higher tax allowances than younger people, so you may be entitled to more income before you have to pay tax. The personal allowance for someone aged 65 to 74 is £6,100 in 2002-2003, £6,370 if you are 75 or over. These extra tax allowances are gradually taken away if your income exceeds a given level (£17,900 in 2002-2003), but they can never go below the basic personal allowance (£4,615 in 2002-2003).

Q I'm a non-taxpayer. How do I avoid paying tax on my savings?

A Non-taxpayers can avoid paying tax on their savings by completing form R85 (available from banks and building societies). This means that you will receive interest at the advertised gross rate. Non-taxpayers who have been paying tax on their savings should contact their tax office to arrange a refund. If you start paying tax, you must cancel the R85 immediately.

COMMON TAX RETURN MISTAKES

Here are some of the most common mistakes people make when filling out their tax returns. Try not to do the same when completing yours.

- Putting a tick next to one of the questions 1 to 9 on p2 of the tax return, but forgetting to send back the relevant supplementary page.
- Putting notes such as 'per P60' or 'information to follow', instead of entering actual or estimated figures.
- Self-employed people attempting to fill in the three-line return for businesses with a turnover of less than £15,000, even when their turnover is considerably more.
- Pensioners inserting the weekly amount of basic pension in question 11 rather than the annual amount.
- Not completing question 19 even if a tax repayment is due.
- Forgetting to sign or date the tax return.

Q I'm self-employed and work from home. Can I offset some of my bills against tax?

A If you work from home, you should be able to claim a proportion of your heating, cleaning, lighting and insurance costs. The proportion depends on how much of the property is used for your business. If you use a part of your home exclusively for business, you may be able to claim a proportion of the mortgage interest and a percentage of the council tax. But there may then be a liability for capital gains tax when you come to sell your house.

Q I'm coming up to retirement. How much money can I put towards my personal pension?

A The Inland Revenue limits contributions to a set percentage of your income based on your age. This starts at 17.5 per cent for the under 35s and then rises (see p55). The amount you can pay depends on the type of pension you have (see p55). With a personal or stakeholder pension, you can invest £3,600 a year regardless of your income.

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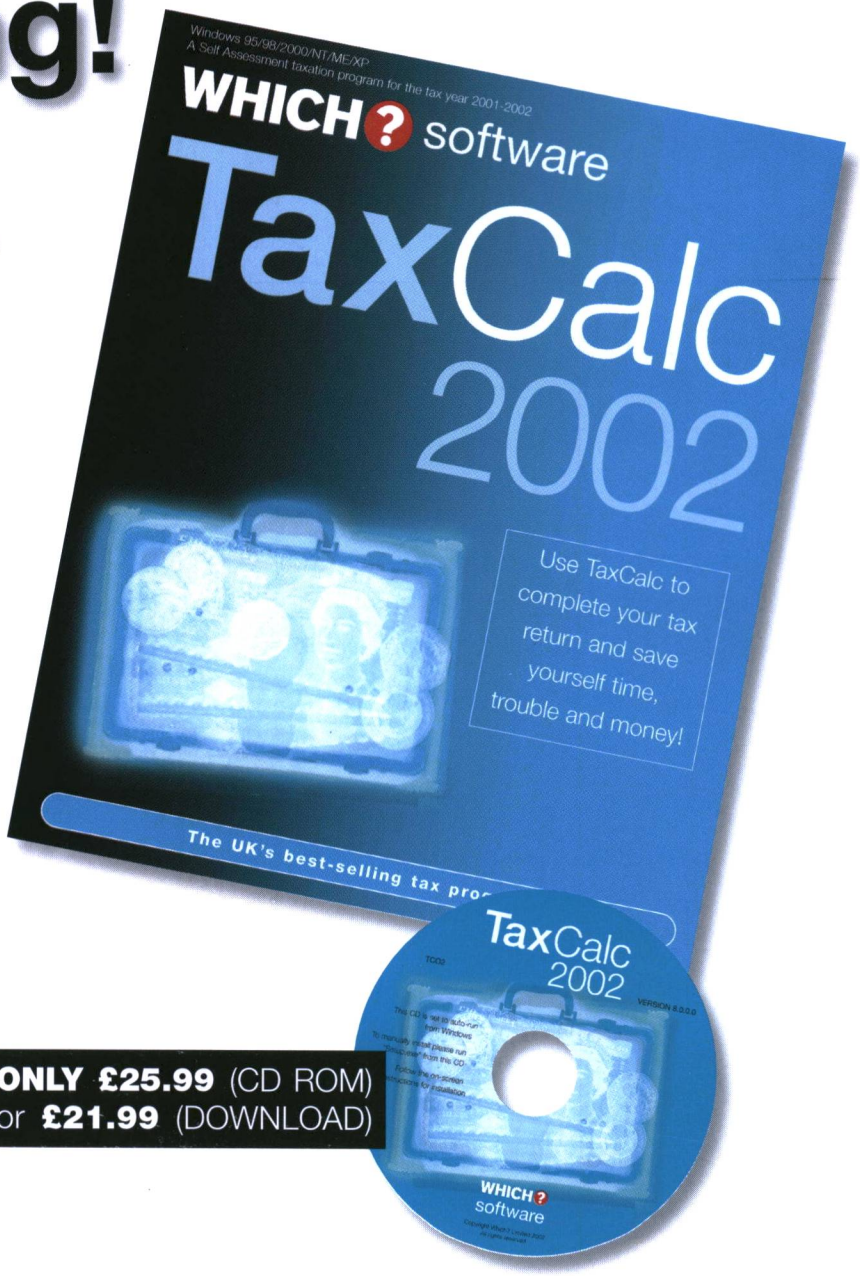

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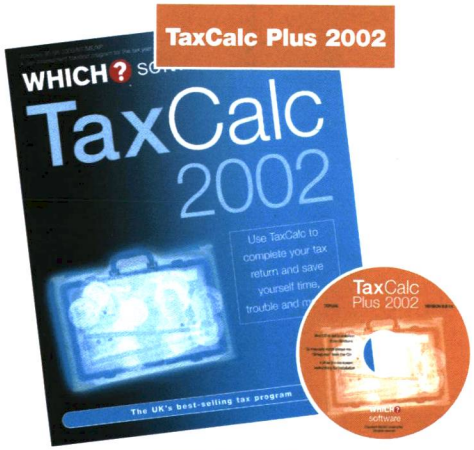

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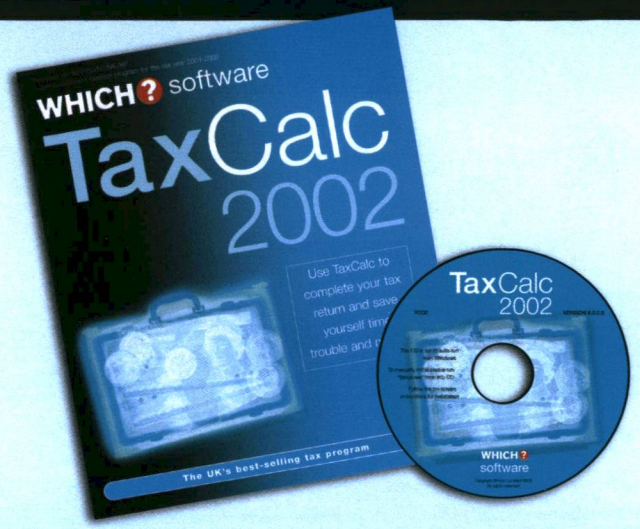

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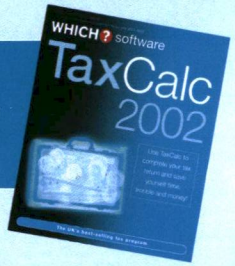

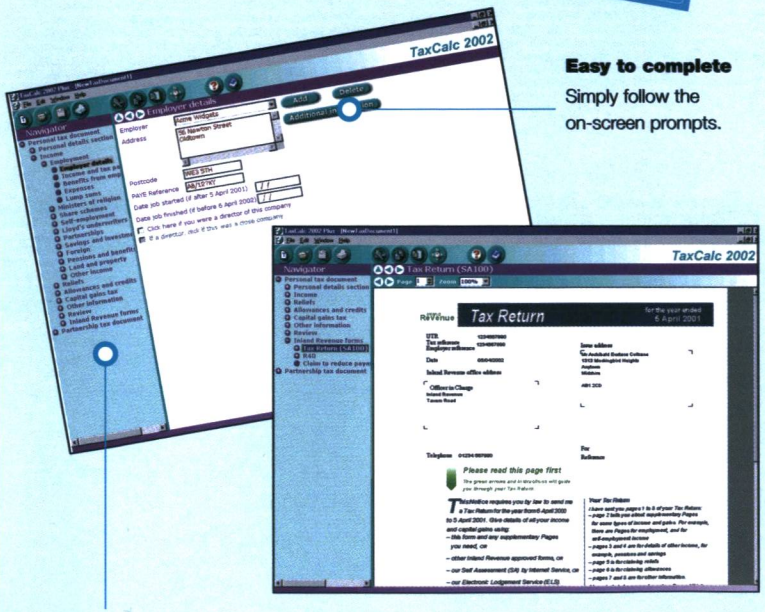

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